



Docket No.: E3331.0629/P629
(PATENT)

IN THE UNITED STATES PATENT AND TRADEMARK OFFICE

In re Patent Application of:
Edward R. Howorka et al.

Confirmation No.: 4196

Application No.: 10/781,703

Filed: February 20, 2004

Art Unit: 3624

For: VOCALISATION OF TRADING DATA IN
TRADING SYSTEMS

Examiner: Not Yet Assigned

PETITION TO MAKE SPECIAL
UNDER 37 CFR 1.102(d)

Commissioner for Patents
P.O. Box 1450
Alexandria, VA 22313-1450

Dear Sir:

Submitted herewith is a Petition to Make Special the above-identified patent application.

Should it be determined that all claims presented are not directed to a single invention, the undersigned, acting for the Applicants, will make an election without traverse, following telephone restriction practice.

08/24/2006 JADD01 00000114 10781703

01 FC:1464

130.00 0P

In support of this Petition, applicants submit the following:

1. Information Disclosure Statements listing each of the references cited herein have already been filed in this application, along with one copy each (as required) of the references most closely related to the subject matter encompassed by the claims. Copies of the references are also being submitted herewith for the convenience of the Office.

2. A search was performed in the counterpart International application PCT/US04/04795 by the ISA/US PCT International Search Authority among the references classified in at least U.S. Class 705, subclass 37, according to the PCT Search Report . A copy of the ISA/US PCT Search Report is submitted herewith. A search was also performed by the UK Patent Office. A copy of the UK Official Action is also enclosed. The claims in the counterparts are of similar scope to those of the present U.S. application.

3. Of the references located in the searches described above, the following are deemed most relevant to the present application. Although these references have previously been made of record, as a courtesy, this paper is accompanied by duplicate copies of these documents.

4. U.S. Patent 5,806,050 to Shinn et al., which shares a common inventor with the present application, relates to vocalizing trading data provided to traders by an anonymous trading system. Shinn et al. shows that trading information that is displayed to traders can also be vocalized. In Shinn et al., vocalization is provided that, for example, serves to highlight information in conjunction with and in addition to text and color data displayed on a trader's workstation display. Particular vocal inflections may be used to help identify what is being vocalized. See e.g., col. 3, lines 47-60. In Shinn et al., the vocalized data relates to the market in the selected currency pair. Thus, tables 1-7 show the types of data that are vocalized. These include the currency pair, the price, market broadcast messages such as

“bid” and “offered,” system deals and price change messages and maker and taker specific messages.

5. U.S. Patent 5,375,055 to Togher et al. does not appear in either the PCT or the UK search. However, it is referred to in the Shinn et al. reference and will be discussed briefly. Togher et al. relates generally to an anonymous trading system in which prices for bids and offers that are displayed on a trader’s workstation have been prescreened for bilateral credit. That is, it is first determined whether sufficient bilateral credit exists between a potential counterparty and the trader before a potential bid/offer from the counterparty is displayed on the trader’s screen. Togher et al. is only relevant to vocalization in that it mentions, at col. 10, lines 13-28, and in reference to table 1, that it would be possible to vocalize displayed price data.

6. Only Shinn et al. was cited in the search report issued by the PCT ISA/US. Shinn et al. and two additional documents were cited in the UK Official Action. Those two additional documents will be briefly discussed as follows.

7. Neither “Rule Enforcement Review of the Community Exchange, Inc. Division of the New York Mercantile Exchange,” <http://www.cftc.gov/tm/tmcomexrer0799.htm>, February 1, 2001, page 2, first paragraph, nor “Morningstar.com’s Interactive Classroom - Course 102 - The Stock Exchanges,” <http://news.morningstar.com/classroom2/printlesson.asp?docID=2955&CN=COM>, 2002 Morning Star, section A, Floor and Branch order ticket reviews, paragraph 3, relate to vocalization of displayed data. Each appears to have been cited in the UK Official Action as teaching that traders and institutions may be allocated unique identifiers.

8. The prior art, taken alone or in combination, does not teach or suggest, the unique combinations of elements recited in the independent claims. In addition to the currency pair information discussed above in relation to Shinn, the independent claims of the

present application adds to the vocalized currency pair information a vocalized identification of the trading floor at which the vocalized trading is announced. Thus, the trading floor identifier is unconnected to the vocalized trading data. The same trading data will be vocalized at many different trading floors but each of those trading floors will additionally vocalize their own unique identifier. Such identification is related to security rather than the trading data itself and, for example, makes a person not entitled to hear the vocalized data aware that he or she is not entitled to hear it.

9. Specifically, as to independent claim 1, none of the abovementioned references, alone or in combination, teach or suggest the feature of the last three lines of the claim: “wherein a trading floor identifier unique to each trading floor is also announced to each trading floor”, as recited in independent claim 1.

10. Further, none of the abovementioned references teach or suggest the limitation: “and announcing at each trading floor an identifier unique to the trading floor”, as recited in independent claim 11.

11. Moreover, none of the abovementioned references teach or suggest the limitation: “wherein an identifier unique to the institution or party to which the trading floor belongs is also announced to each trading floor”, as recited in independent claim 20.

12. Further, none of the abovementioned references teach or suggest the limitation: “and announcing an identifier unique to a trading floor, or the institution to which it belongs, at each trading floor”, as recited in independent claim 27.

13. Further, none of the abovementioned references teach or suggest the limitation: “the vocalisation unit further announcing an identifier unique to the trading floor of which the trader terminal is a part”, as recited in independent claim 37.

14. Accordingly, applicants request that this Petition to Make Special be granted and the application undergo accelerated examination.

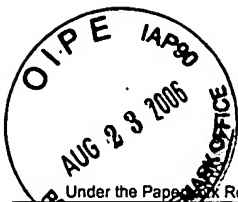
15. Please charge our Credit Card in the amount of \$130.00 covering the fee set forth in 37 CFR 1.17(h) or (i). Credit Card Payment Form SB-2038 is enclosed. The Director is hereby authorized to charge any deficiency in the fees filed, asserted to be filed or which should have been filed herewith (or with any paper hereafter filed in this application by this firm) to our Deposit Account No. 50-2215.

Dated: August 22, 2006

Respectfully submitted,

By Joseph W. Ragusa
Joseph W. Ragusa

Registration No.: 38,586
DICKSTEIN SHAPIRO LLP
1177 Avenue of the Americas
41st Floor
New York, New York 10036-2714
(212) 277-6500
Attorney for Applicant



PTO/SB/17 (07-06)
Approved for use through 01/31/2007. OMB 0651-0032
U.S. Patent and Trademark Office; U.S. DEPARTMENT OF COMMERCE
Under the Paperwork Reduction Act of 1995, no person are required to respond to a collection of information unless it displays a valid OMB control number.

FEE TRANSMITTAL For FY 2005 <input type="checkbox"/> Applicant claims small entity status. See 37 CFR 1.27		Complete if Known			
		Application Number	10/781,703-Conf. #4196		
		Filing Date	February 20, 2004		
		First Named Inventor	Edward R. Howorka		
		Examiner Name	Not Yet Assigned		
TOTAL AMOUNT OF PAYMENT		(\$)	130.00	Attorney Docket No.	E3331.0629

METHOD OF PAYMENT (check all that apply)

☐ Check ☒ Credit Card ☐ Money Order ☐ None ☐ Other (please identify): _____

☒ Deposit Account Deposit Account Number: 50-2215 Deposit Account Name: Dickstein Shapiro LLP

For the above-identified deposit account, the Director is hereby authorized to: (check all that apply)

☐ Charge fee(s) indicated below ☐ Charge fee(s) indicated below, except for the filing fee

☒ Charge any additional fee(s) or underpayment of fee(s) under 37 CFR 1.16 and 1.17 ☒ Credit any overpayments

FEE CALCULATION

1. BASIC FILING, SEARCH, AND EXAMINATION FEES

Application Type	FILING FEES		SEARCH FEES		EXAMINATION FEES		Fees Paid (\$)
	Fee (\$)	Small Entity Fee (\$)	Fee (\$)	Small Entity Fee (\$)	Fee (\$)	Small Entity Fee (\$)	
Utility	300	150	500	250	200	100	
Design	200	100	100	50	130	65	
Plant	200	100	300	150	160	80	
Reissue	300	150	500	250	600	300	
Provisional	200	100	0	0	0	0	

2. EXCESS CLAIM FEES

Fee Description	Fee (\$)	Small Entity Fee (\$)
Each claim over 20 (including Reissues)	50	25
Each independent claim over 3 (including Reissues)	200	100
Multiple dependent claims	360	180

Total Claims	Extra Claims	Fee (\$)	Fee Paid (\$)	Multiple Dependent Claims	Fee (\$)	Fee Paid (\$)

HP = highest number of total claims paid for, if greater than 20.

Indep. Claims	Extra Claims	Fee (\$)	Fee Paid (\$)

HP = highest number of independent claims paid for, if greater than 3.

3. APPLICATION SIZE FEE

If the specification and drawings exceed 100 sheets of paper (excluding electronically filed sequence or computer listings under 37 CFR 1.52(e)), the application size fee due is \$250 (\$125 for small entity) for each additional 50 sheets or fraction thereof. See 35 U.S.C. 41(a)(1)(G) and 37 CFR 1.16(s).

Total Sheets	Extra Sheets	Number of each additional 50 or fraction thereof	Fee (\$)	Fee Paid (\$)

4. OTHER FEE(S)

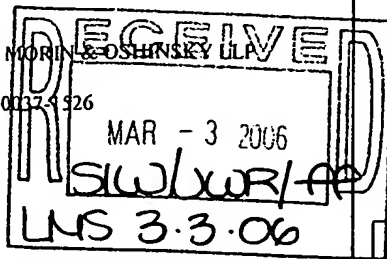
	Fees Paid (\$)
Non-English Specification, \$130 fee (no small entity discount)	
Other (e.g., late filing surcharge): 1464 Petitions to the Director not specifically ...	130.00

SUBMITTED BY			
Signature	<i>Joseph W. Ragusa</i>	Registration No. (Attorney/Agent)	38,586
Name (Print/Type)	Joseph W. Ragusa	Telephone	(212) 277-6584
		Date	August 23, 2006

PATENT COOPERATION TREATY

From the INTERNATIONAL SEARCHING AUTHORITY

To:
STEPHEN A. SOFFEN
DICKSTEIN SHAPIRO MORIN & OSHINSKY LLP
2101 L STREET NW
WASHINGTON, DC 20037-4526



PCT

NOTIFICATION OF TRANSMITTAL OF
THE INTERNATIONAL SEARCH REPORT AND
THE WRITTEN OPINION OF THE INTERNATIONAL
SEARCHING AUTHORITY, OR THE DECLARATION

(PCT Rule 44.1)

Date of mailing (day/month/year) **02 MAR 2006**

Applicant's or agent's file reference
E33310628-PC

FOR FURTHER ACTION See paragraphs 1 and 4 below

International application No.
PCT/US04/04795

International filing date
(day/month/year) 20 February 2004 (20.02.2004)

Applicant
ELECTRONIC BROKING SERVICES LIMITED

1. ☒ The applicant is hereby notified that the international search report and the written opinion of the International Searching Authority have been established and are transmitted herewith.

Filing of amendments and statement under Article 19:

The applicant is entitled, if he so wishes, to amend the claims of the international application (see Rule 46):

When? The time limit for filing such amendments is normally two months from the date of transmittal of the international search report.

Where? Directly to the International Bureau of WIPO, 34 chemin des Colombettes
1211 Geneva 20, Switzerland, Facsimile No.: (41-22) 338.82.70.

For more detailed instructions, see the notes on the accompanying sheet.

2. ☐ The applicant is hereby notified that no international search report will be established and that the declaration under Article 17(2)(a) to that effect and the written opinion of the International Searching Authority are transmitted herewith.

3. ☐ With regard to the protest against payment of (an) additional fee(s) under Rule 40.2, the applicant is notified that:

☐ the protest together with the decision thereon has been transmitted to the International Bureau together with the applicant's request to forward the texts of both the protest and the decision thereon to the designated Offices.

☐ no decision has been made yet on the protest; the applicant will be notified as soon as a decision is made.

4. **Reminders**

Shortly after the expiration of 18 months from the priority date, the international application will be published by the International Bureau. If the applicant wishes to avoid or postpone publication, a notice of withdrawal of the international application, or of the priority claim, must reach the International Bureau as provided in Rules 90bis.1 and 90bis.3, respectively, before the completion of the technical preparations for international publication.

The applicant may submit comments on an informal basis on the written opinion of the International Searching Authority to the International Bureau. The International Bureau will send a copy of such comments to all designated Offices unless an international preliminary examination report has been or is to be established. These comments would also be made available to the public but not before the expiration of 30 months from the priority date.

Within 19 months from the priority date, but only in respect of some designated Offices, a demand for international preliminary examination must be filed if the applicant wishes to postpone the entry into the national phase until 30 months from the priority date (in some Offices even later); otherwise, the applicant must, within 20 months from the priority date, perform the prescribed acts for entry into the national phase before those designated Offices.

In respect of other designated Offices, the time limit of 30 months (or later) will apply even if no demand is filed within 19 months.

See the Annex to Form PCT/IB/301 and, for details about the applicable time limits, Office by Office, see the *PCT Applicant's Guide*, Volume II, National Chapters and the WIPO Internet site.

Name and mailing address of the ISA/ US
Mail Stop PCT, Attn: ISA/US
Commissioner for Patents
P.O. Box 1450
Alexandria, Virginia 22313-1450
Facsimile No. (571) 273-3201

Authorized officer
W. Wildermuth
Rich Weisberger

Telephone No. 571-272-6753

Form PCT/ISA/220 (January 2004)

(See notes on accompanying sheet)

E3331.0629
1 APRIL 2006 - 155 30 DAYS
31 MAY 2006 - 165 90 DAYS
SIW/RE/FA/MRL

PATENT COOPERATION TREATY

PCT

INTERNATIONAL SEARCH REPORT

(PCT Article 18 and Rules 43 and 44)

Applicant's or agent's file reference E33310628-PC	FOR FURTHER ACTION	see Notification of Transmittal of International Search Report (Form PCT/ISA/220) as well as, where applicable, item 5 below.
International application No. PCT/US04/04795	International filing date (<i>day/month/year</i>) 20 February 2004 (20.02.2004)	(Earliest) Priority Date (<i>day/month/year</i>) 21 February 2003 (21.02.2003)
Applicant ELECTRONIC BROKING SERVICES LIMITED		

This international search report has been prepared by this International Searching Authority and is transmitted to the applicant according to Article 18. A copy is being transmitted to the International Bureau.

This international search report consists of a total of 2 sheets.



It is also accompanied by a copy of each prior art document cited in this report.

1. Basis of the Report

a. With regard to the language, the international search was carried out on the basis of the international application in the language in which it was filed, unless otherwise indicated under this item.

☐

the international search was carried out on the basis of a translation of the international application furnished to this Authority (Rule 23.1(b)).

b. With regard to any nucleotide and/or amino acid sequence disclosed in the international application, the international search was carried out on the basis of the sequence listing:

☐

contained in the international application in written form.

☐

filed together with the international application in computer readable form.

☐

furnished subsequently to this Authority in written form.

☐

furnished subsequently to this Authority in computer readable form.

☐

the statement that the subsequently furnished written sequence listing does not go beyond the disclosure in the international application as filed has been furnished.

☐

the statement that the information recorded in computer readable form is identical to the written sequence listing has been furnished.

2. ☐ Certain claims were found unsearchable (See Box I).

3. ☐ Unity of invention is lacking (See Box II).

4. With regard to the title,

☒

the text is approved as submitted by the applicant.

☐

the text has been established by this Authority to read as follows:

5. With regard to the abstract,

☒

the text is approved as submitted by the applicant.

☐

the text has been established, according to Rule 38.2(b), by this Authority as it appears in Box III. The applicant may, within one month from the date of mailing of this international search report, submit comments to this Authority.

6. The figure of the drawings to be published with the abstract is Figure No. _____

☐

as suggested by the applicant.

☐

because the applicant failed to suggest a figure.

☐

because this figure better characterizes the invention.



None of the figures

INTERNATIONAL SEARCH REPORT

International application No.

PCT/US04/04795

A. CLASSIFICATION OF SUBJECT MATTER

IPC(8) : G06F 17/60

US CL : 705//37

According to International Patent Classification (IPC) or to both national classification and IPC

B. FIELDS SEARCHED

Minimum documentation searched (classification system followed by classification symbols)

U.S. : 705//37

Documentation searched other than minimum documentation to the extent that such documents are included in the fields searched

Electronic data base consulted during the international search (name of data base and, where practicable, search terms used)

C. DOCUMENTS CONSIDERED TO BE RELEVANT

Category *	Citation of document, with indication, where appropriate, of the relevant passages	Relevant to claim No.
A	US 5,806,050 A (Shinn et al) 8 Sept 1998 (08.09.1998)	1-37

☐ Further documents are listed in the continuation of Box C.☐ See patent family annex.

Special categories of cited documents:	
"A" document defining the general state of the art which is not considered to be of particular relevance	"T" later document published after the international filing date or priority date and not in conflict with the application but cited to understand the principle or theory underlying the invention
"E" earlier application or patent published on or after the international filing date	"X" document of particular relevance; the claimed invention cannot be considered novel or cannot be considered to involve an inventive step when the document is taken alone
"L" document which may throw doubts on priority claim(s) or which is cited to establish the publication date of another citation or other special reason (as specified)	"Y" document of particular relevance; the claimed invention cannot be considered to involve an inventive step when the document is combined with one or more other such documents, such combination being obvious to a person skilled in the art
"O" document referring to an oral disclosure, use, exhibition or other means	"&" document member of the same patent family
"P" document published prior to the international filing date but later than the priority date claimed	

Date of the actual completion of the international search

13 June 2005 (13.06.2005)

Date of mailing of the international search report

02 MAR 2006

Name and mailing address of the ISA/US

Mail Stop PCT, Attn: ISA/US
Commissioner of Patents
P.O. Box 1450
Alexandria, Virginia 22313-1450

Authorized officer

D. Wildermuth for
Rich Weisberger

Telephone No. 571 272 6753

Facsimile No. (703)305-3230

Form PCT/ISA/210 (second sheet) (July 1998)

PATENT COOPERATION TREATY

From the
INTERNATIONAL SEARCHING AUTHORITY

To:
STEPHEN A. SOFFEN
DICKSTEIN SHAPIRO MORIN & OSHINSKY LLP
2101 L STREET NW
WASHINGTON, DC 20037-1526

PCT

WRITTEN OPINION OF THE
INTERNATIONAL SEARCHING AUTHORITY

(PCT Rule 43bis.1)

Applicant's or agent's file reference E33310628-PC		Date of mailing (day/month/year) 02 MAR 2006
		FOR FURTHER ACTION See paragraph 2 below
International application No. PCT/US04/04795	International filing date (day/month/year) 20 February 2004 (20.02.2004)	Priority date (day/month/year) 21 February 2003 (21.02.2003)
International Patent Classification (IPC) or both national classification and IPC IPC⁸: G06F 17/60 and US Cl.: 705//37		
Applicant ELECTRONIC BROKING SERVICES LIMITED		

1. This opinion contains indications relating to the following items:

- | | | |
|-------------------------------------|--------------|--|
| <input checked="" type="checkbox"/> | Box No. I | Basis of the opinion |
| <input type="checkbox"/> | Box No. II | Priority |
| <input type="checkbox"/> | Box No. III | Non-establishment of opinion with regard to novelty, inventive step and industrial applicability |
| <input type="checkbox"/> | Box No. IV | Lack of unity of invention |
| <input checked="" type="checkbox"/> | Box No. V | Reasoned statement under Rule 43bis.1(a)(i) with regard to novelty, inventive step or industrial applicability; citations and explanations supporting such statement |
| <input type="checkbox"/> | Box No. VI | Certain documents cited |
| <input type="checkbox"/> | Box No. VII | Certain defects in the international application |
| <input type="checkbox"/> | Box No. VIII | Certain observations on the international application |

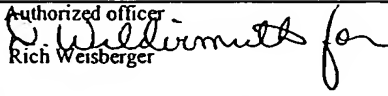
2. FURTHER ACTION

If a demand for international preliminary examination is made, this opinion will be considered to be a written opinion of the International Preliminary Examining Authority ("IPEA") except that this does not apply where the applicant chooses an Authority other than this one to be the IPEA and the chosen IPEA has notified the International Bureau under Rule 66.1bis(b) that written opinions of this International Searching Authority will not be so considered.

If this opinion is, as provided above, considered to be a written opinion of the IPEA, the applicant is invited to submit to the IPEA a written reply together, where appropriate, with amendments, before the expiration of 3 months from the date of mailing of Form PCT/ISA/220 or before the expiration of 22 months from the priority date, whichever expires later.

For further options, see Form PCT/ISA/220.

3. For further details, see notes to Form PCT/ISA/220.

Name and mailing address of the ISA/ US Mail Stop PCT, Attn: ISA/US Commissioner for Patents P.O. Box 1450 Alexandria, Virginia 22313-1450 Facsimile No. (703)305-3230	Authorized officer  Rich Weisberger Telephone No. 571 272 6753
---	---

WRITTEN OPINION OF THE
INTERNATIONAL SEARCHING AUTHORITY

International application No.

PCT/US04/04795

Box No. I Basis of this opinion

1. With regard to the language, this opinion has been established on the basis of the international application in the language in which it was filed, unless otherwise indicated under this item.

☐ This opinion has been established on the basis of a translation from the original language into the following language _____, which is the language of a translation furnished for the purposes of international search (under Rules 12.3 and 23.1(b)).

2. With regard to any nucleotide and/or amino acid sequence disclosed in the international application and necessary to the claimed invention, this opinion has been established on the basis of:

a. type of material

☐ a sequence listing

☐ table(s) related to the sequence listing

b. format of material

☐ in written format

☐ in computer readable form

c. time of filing/furnishing

☐ contained in international application as filed.

☐ filed together with the international application in computer readable form.

☐ furnished subsequently to this Authority for the purposes of search.

3. ☐ In addition, in the case that more than one version or copy of a sequence listing and/or table relating thereto has been filed or furnished, the required statements that the information in the subsequent or additional copies is identical to that in the application as filed or does not go beyond the application as filed, as appropriate, were furnished.

4. Additional comments:

WRITTEN OPINION OF THE
INTERNATIONAL SEARCHING AUTHORITY

International application No.
PCT/US04/04795

Box No. V Reasoned statement under Rule 43 *bis*.1(a)(i) with regard to novelty, inventive step or industrial applicability; citations and explanations supporting such statement

1. Statement

Novelty (N)	Claims <u>1-37</u>	YES
	Claims <u>NONE</u>	NO
Inventive step (IS)	Claims <u>1-37</u>	YES
	Claims <u>NONE</u>	NO
Industrial applicability (IA)	Claims <u>1-37</u>	YES
	Claims <u>NONE</u>	NO

2. Citations and explanations:

Claims 1-37 meet the criteria set out in PCT Article 33(2)-(3), because the prior art does not teach or fairly suggest trading system with audibly announcement features.

Claims 1-37 meet the criteria set out in PCT Article 33(4), and thus have industrial applicability because the subject matter claimed can be made or used in industry.

NOTES TO FORM PCT/ISA/220 (continued)

The letter must indicate the differences between the claims as filed and the claims as amended. It must, in particular, indicate, in connection with each claim appearing in the international application (it being understood that identical indications concerning several claims may be grouped), whether

- (i) the claim is unchanged;
- (ii) the claim is cancelled;
- (iii) the claim is new;
- (iv) the claim replaces one or more claims as filed;
- (v) the claim is the result of the division of a claim as filed.

The following examples illustrate the manner in which amendments must be explained in the accompanying letter:

1. [Where originally there were 48 claims and after amendment of some claims there are 51]:
"Claims 1 to 29, 31, 32, 34, 35, 37 to 48 replaced by amended claims bearing the same numbers; claims 30, 33 and 36 unchanged; new claims 49 to 51 added."
2. [Where originally there were 15 claims and after amendment of all claims there are 11]:
"Claims 1 to 15 replaced by amended claims 1 to 11."
3. [Where originally there were 14 claims and the amendments consist in cancelling some claims and in adding new claims]:
"Claims 1 to 6 and 14 unchanged; claims 7 to 13 cancelled; new claims 15, 16 and 17 added." or
"Claims 7 to 13 cancelled; new claims 15, 16 and 17 added; all other claims unchanged."
4. [Where various kinds of amendments are made]:
"Claims 1-10 unchanged; claims 11 to 13, 18 and 19 cancelled; claims 14, 15 and 16 replaced by amended claim 14; claim 17 subdivided into amended claims 15, 16 and 17; new claims 20 and 21 added."

"Statement under Article 19(1)" (Rule 46.4)

The amendments may be accompanied by a statement explaining the amendments and indicating any impact that such amendments might have on the description and the drawings (which cannot be amended under Article 19(1)).

The statement will be published with the international application and the amended claims.

It must be in the language in which the international application is to be published.

It must be brief, not exceeding 500 words if in English or if translated into English.

It should not be confused with and does not replace the letter indicating the differences between the claims as filed and as amended. It must be filed on a separate sheet and must be identified as such by a heading, preferably by using the words "Statement under Article 19(1)."

It may not contain any disparaging comments on the international search report or the relevance of citations contained in that report. Reference to citations, relevant to a given claim, contained in the international search report may be made only in connection with an amendment of that claim.

Consequence if a demand for international preliminary examination has already been filed

If, at the time of filing any amendments and any accompanying statement, under Article 19, a demand for international preliminary examination has already been submitted, the applicant must preferably, at the time of filing the amendments (and any statement) with the International Bureau, also file with the International Preliminary Examining Authority a copy of such amendments (and of any statement) and, where required, a translation of such amendments for the procedure before that Authority (see Rules 55.3(a) and 62.2, first sentence). For further information, see the Notes to the demand form (PCT/IPEA/401).

If a demand for international preliminary examination is made, the written opinion of the International Searching Authority will, except in certain cases where the International Preliminary Examining Authority did not act as International Searching Authority and where it has notified the International Bureau under Rule 66.1bis(b), be considered to be a written opinion of the International Preliminary Examining Authority. If a demand is made, the applicant may submit to the International Preliminary Examining Authority a reply to the written opinion together, where appropriate, with amendments before the expiration of 3 months from the date of mailing of Form PCT/ISA/220 or before the expiration of 22 months from the priority date, whichever expires later (Rule 43bis.1(c)).

Consequence with regard to translation of the international application for entry into the national phase

The applicant's attention is drawn to the fact that, upon entry into the national phase, a translation of the claims as amended under Article 19 may have to be furnished to the designated/elected Offices, instead of, or in addition to, the translation of the claims as filed.

For further details on the requirements of each designated/elected Office, see the *PCT Applicant's Guide*, Volume II.

NOTES TO FORM PCT/ISA/220

These Notes are intended to give the basic instructions concerning the filing of amendments under Article 19. The Notes are based on the requirements of the Patent Cooperation Treaty, the Regulations and the Administrative Instructions under that Treaty. In case of discrepancy between these Notes and those requirements, the latter are applicable. For more detailed information, see also the *PCT Applicant's Guide*, a publication of WIPO.

In these Notes, "Article," "Rule" and "Section" refer to the provisions of the PCT, the PCT Regulations and the PCT Administrative Instructions, respectively.

INSTRUCTIONS CONCERNING AMENDMENTS UNDER ARTICLE 19

The applicant has, after having received the international search report and the written opinion of the International Searching Authority, one opportunity to amend the claims of the international application. It should however be emphasized that, since all parts of the international application (claims, description and drawings) may be amended during the international preliminary examination procedure, there is usually no need to file amendments of the claims under Article 19 except where, e.g. the applicant wants the latter to be published for the purposes of provisional protection or has another reason for amending the claims before international publication. Furthermore, it should be emphasized that provisional protection is available in some States only (see *PCT Applicant's Guide*, Volume I/A, Annexes B1 and B2).

The attention of the applicant is drawn to the fact that amendments to the claims under Article 19 are not allowed where the International Searching Authority has declared, under Article 17(2), that no international search report would be established (see *PCT Applicant's Guide*, Volume I/A, paragraph 296).

What parts of the international application may be amended ?

Under Article 19, only the claims may be amended.

During the international phase, the claims may also be amended (or further amended) under Article 34 before the International Preliminary Examining Authority. The description and drawings may only be amended under Article 34 before the International Preliminary Examining Authority.

Upon entry into the national phase, all parts of the international application may be amended under Article 28 or, where applicable, Article 41.

When ? Within 2 months from the date of transmittal of the international search report or 16 months from the priority date, whichever time limit expires later. It should be noted, however, that the amendments will be considered as having been received on time if they are received by the International Bureau after the expiration of the applicable time limit but before the completion of the technical preparations for international publication (Rule 46.1).

Where not to file the amendments ?

The amendments may only be filed with the International Bureau and not with the receiving Office or the International Searching Authority (Rule 46.2).

Where a demand for international preliminary examination has been/is filed, see below.

How ? Either by cancelling one or more entire claims, by adding one or more new claims or by amending the text of one or more of the claims as filed.

A replacement sheet must be submitted for each sheet of the claims which, on account of an amendment or amendments, differs from the sheet originally filed.

All the claims appearing on a replacement sheet must be numbered in Arabic numerals. Where a claim is cancelled, no renumbering of the other claims is required. In all cases where claims are renumbered, they must be renumbered consecutively (Section 205(b)).

The amendments must be made in the language in which the international application is to be published.

What documents must/may accompany the amendments ?

Letter (Section 205(b)):

The amendments must be submitted with a letter.

The letter will not be published with the international application and the amended claims. It should not be confused with the "Statement under Article 19(1)" (see below, under "Statement under Article 19(1)").

The letter must be in English or French, at the choice of the applicant. However, if the language of the international application is English, the letter must be in English; if the language of the international application is French, the letter must be in French.

PATENT COOPERATION TREATY

From the INTERNATIONAL SEARCHING AUTHORITY

To:
STEPHEN A. SOFFEN
DICKSTEIN SHAPIRO MORIN & OSHINSKY LLP
2101 L STREET NW
WASHINGTON, DC 20037-1526

PCT

NOTIFICATION OF TRANSMITTAL OF
THE INTERNATIONAL SEARCH REPORT AND
THE WRITTEN OPINION OF THE INTERNATIONAL
SEARCHING AUTHORITY, OR THE DECLARATION

(PCT Rule 44.1)

Applicant's or agent's file reference E33310628-PC	Date of mailing (day/month/year)
International application No. PCT/US04/04795	International filing date (day/month/year) 20 February 2004 (20.02.2004)
Applicant ELECTRONIC BROKING SERVICES LIMIT	

1. ☒ The applicant is here¹ have been established :

Filing of amendments and **19:**
 The applicant is entitled, if he . . . time of the international application (see Rule 46):

When? The time limit for filing
 search report.

Where? Directly to the International Bureau of WIPO, 34 chemin des Colombettes
 1211 Geneva 20, Switzerland, Facsimile No.: (41-22) . 18.82.70.

For more detailed instructions, see the notes on the accompanying sheet.
2. ☐ The applicant is hereby notified that no international search report will be established and that the declaration under Article 17(2)(a) to that effect and the written opinion of the International Searching Authority are transmitted herewith.
3. ☐ With regard to the protest against payment of (an) additional fee(s) under Rule 40.2, the applicant is notified that:
 - ☐ the protest together with the decision thereon has been transmitted to the International Bureau together with the applicant's request to forward the texts of both the protest and the decision thereon to the designated Offices.
 - ☐ no decision has been made yet on the protest; the applicant will be notified as soon as a decision is made.
4. **Reminders**
 Shortly after the expiration of 18 months from the priority date, the international application will be published by the International Bureau. If the applicant wishes to avoid or postpone publication, a notice of withdrawal of the international application, or of the priority claim, must reach the International Bureau as provided in Rules 90bis.1 and 90bis.3, respectively, before the completion of the technical preparations for international publication.
 The applicant may submit comments on an informal basis on the written opinion of the International Searching Authority to the International Bureau. The International Bureau will send a copy of such comments to all designated Offices unless an international preliminary examination report has been or is to be established. These comments would also be made available to the public but not before the expiration of 30 months from the priority date.
 Within 19 months from the priority date, but only in respect of some designated Offices, a demand for international preliminary examination must be filed if the applicant wishes to postpone the entry into the national phase until 30 months from the priority date (in some Offices even later); otherwise, the applicant must, within 20 months from the priority date, perform the prescribed acts for entry into the national phase before those designated Offices.
 In respect of other designated Offices, the time limit of 30 months (or later) will apply even if no demand is filed within 19 months.
 See the Annex to Form PCT/IB/301 and, for details about the applicable time limits, Office by Office, see the *PCT Applicant's Guide*, Volume II, National Chapters and the WIPO Internet site.

Name and mailing address of the ISA/ US Mail Stop PCT, Attn: ISA/US Commissioner for Patents P.O. Box 1450 Alexandria, Virginia 22313-1450 Facsimile No. (571) 273-3201	Authorized officer Rich Weisberger Telephone No. 571-272-6753
--	---



Your ref : P/45276.GB01/PADL
Application No: GB0515696.3
Applicant : EBS Group Limited

Examiner : Mr Jim Calvert
Tel : 01633 814748
Date of report : 10 March 2006

Latest date for reply: 10 July 2006

Page 1/2

Patents Act 1977

Examination Report under Section 18(3)

Basis of the examination

1. I have examined your application in the form that it was printed by WIPO when it was in the international phase.

Inventive step

2. The invention as defined in claims 1,11,20,27,37 is obvious in view of what has already been disclosed in the following documents:

US5806050 A (SHINN) Referred to on page 1 of your specification

Rule enforcement review of the commodity exchange,inc.division of the New York Mercantile Exchange

<http://www.cftc.gov/tm/tmcomexrer0799.htm> February 1st 2001, see page 2, 1st para..

Morningstar.com's Interactive Classroom - Course 102 - The Stock Exchanges

<http://news.morningstar.com/classroom2/printlesson.asp?docId=2955&CN=COM>
2002 Morning Star, section A, Floor and Branch order ticket reviews, para. 3

3. The invention relates to vocalisation of trading data. I consider that the skilled addressee would be a designer of trading systems.

4. The purported inventive step relates to announcement of an identifier unique to either a trading floor or an institution.

5. Any designer of trading systems would be familiar with how conventional trading operates and that trading floors, traders and institutions are allocated unique identifiers, as evidenced by the internet documents cited above. It would therefore be obvious for the designer of a trading system to include announcement of an identifier to avoid illicit communication of data.

Your ref : P/45276.GB01/PADL
Application No : GB0515696.3

Date of report: 10 March 2006
Page 2 / 2

[Examination Report contd.]

Excluded Inventions

6. Following the recent High Court decision in CFPH LLC's Application [2005] EWHC 1589 Pat and the subsequent practice notice, "Patents Act 1977: Examining for Patentability" issued by the Patent Office, I will follow a two-step test as regards exclusion:-

- (1) Identify what is the advance in the art that is said to be new and not obvious (and susceptible of industrial application).
- (2) Determine whether it is both new and not obvious (and susceptible of industrial application under the description of an "invention" in the sense of Article 52 of the European Patent Convention).

7. The advance is the announcement of an identifier unique to either the trading floor or the institution. I have dealt with the question of obviousness in paragraphs 2 to 5 above.

8. As far as being susceptible of industrial application under the description of an "invention" in the sense of Article 52 of the European Patent Convention, I consider that the advance is not so, and is therefore contrary to Section 1(2)(c) of the Patents Act. This is because the advance relates to a business method as the step of announcing the identifier is defined in terms of a trading floor or an institution.

9. I also consider that the announcement of the identifier is presentation of information contrary to Section 1(2)(d) as it is distinguished by information presented to the trader.

10. These considerations appear to apply equally to all of the independent claims 1, 11, 20, 27 and 37.

Clarity

11. Claim 1 states that "at least a portion of the data is audibly announced" but when subsequently referring to the announcement of the identifier it merely states that the identifier is announced, i.e. not necessarily audibly. If it is intended that the identifier is announced audibly then this should be explicitly stated to make it precisely clear what the purported inventive advance is.



INPROTECH		TERM:	
TECHNICAL	100		
PUBLNS			
E.P.G.		DATE:	
FOREIGNS		10/7/06	
REGISTERS			
A.F.S. TRANS		INITIAL	CHECK
A.F.S. NON		gc	gc
POST GRANT			

RECEIVED
13 MAR 2006

EBS Group Limited
c/o Reddie & Grose
16 Theobalds Road
LONDON
WC1X 8PL

The Patent Office
Patents Directorate

Concept House
Cardiff Road, Newport
South Wales, NP10 8QQ

Examiner: 01633 814748
E-Mail: jim.calvert@patent.gov.uk
Switchboard: 01633 814000
Fax: 01633 814444
Minicom: 08459 222250
DX: 722540/41 Cleppa Park 3
<http://www.patent.gov.uk>

Your Reference: P/45276.GB01/PADL
Application No: GB0515696.3

10 March 2006

Dear Sirs

Patents Act 1977: Examination Report under Section 18(3)

Latest date for reply: **10 July 2006**

I enclose two copies of my examination report and a copy of the new citations. As the International Search Report has not yet been issued I have carried out a full search and I also enclose a search report in this respect.

As agreed with your agent in the telephone conversation of 8th March 2006, the full search fee of £100 is due, the International Search Report not yet having been issued, as opposed to the lower fee of £80 already paid.

By the above date you should either file amendments to meet the objections in the enclosed report or make observations on them. If you do not, the application may be refused.

Yours faithfully

Mr Jim Calvert
Examiner

Application No: GB0515696.3
 Claims searched: 1, 11, 20, 27, 37

Examiner: Mr Jim Calvert
 Date of search: 9 March 2006

Patents Act 1977: Search Report under Section 17

Documents considered to be relevant:

Category	Relevant to claims	Identity of document and passage or figure of particular relevance
Y	1, 11, 20, 27, 37	US5806050 A (SHINN) Referred to on page 1 of the specification
Y	1, 11, 20, 27, 37	Rule enforcement review of the commodity exchange, inc. division of the New York Mercantile Exchange < http://www.cftc.gov/tm/tmcomexrer0799.htm > February 1st 2001, see page 2, 1st para..
Y	1, 11, 20, 27, 37	Morningstar.com's Interactive Classroom - Course 102 - The Stock Exchanges < http://news.morningstar.com/classroom2/printlesson.asp?docId=2955&CN=COM > 2002 Morning Star, section A Floor and Branch order ticket reviews, para. 3

Categories:

X	Document indicating lack of novelty or inventive step	A	Document indicating technological background and/or state of the art.
Y	Document indicating lack of inventive step if combined with one or more other documents of same category.	P	Document published on or after the declared priority date but before the filing date of this invention.
&	Member of the same patent family	E	Patent document published on or after, but with priority date earlier than, the filing date of this application.

Field of Search:

Search of GB, EP, WO & US patent documents classified in the following areas of the UKC^x :

Worldwide search of patent documents classified in the following areas of the IPC

G06Q; H04L

The following online and other databases have been used in the preparation of this search report

WPI, EPODOC, Internet

RULE ENFORCEMENT REVIEW OF THE COMMODITY EXCHANGE, INC. DIVISION OF THE NEW YORK MERCANTILE EXCHANGE

I. INTRODUCTION - PURPOSE AND SCOPE

The Division of Trading and Markets ("Division") has completed a limited-scope rule enforcement review of the self-regulatory programs of the Commodity Exchange, Inc. Division ("COMEX" or "Exchange") of the New York Mercantile Exchange ("NYMEX").¹ The purpose of this review was to evaluate certain aspects of the Exchange's audit trail system for compliance with Regulation 1.35 and to evaluate the Exchange's trade practice surveillance and disciplinary programs for compliance with Sections 5a(a)(8) and 5a(b) of the Commodity Exchange Act ("Act") and Commission Regulation 1.51. This review was limited in scope because the Division recently evaluated the Exchange's audit trail, trade practice surveillance, and disciplinary programs as part of its review of the Exchange's petition for exemption from the dual trading prohibition contained in Section 4j(a) of the Act and Commission Regulation 155.5.² The Commission granted the Exchange's petition by Order dated May 6, 1997.³ In granting the Order, the Commission concluded that the Exchange's floor surveillance, audit trail, recordkeeping, surveillance, and disciplinary programs satisfied the requisite standards set forth in the Act to detect and deter dual trading-related abuses.⁴ The Commission further found that the Exchange committed sufficient resources to be effective in detecting and deterring violations by, among other things, maintaining an adequate staff to investigate and to prosecute disciplinary actions.

This review covers the period of July 1, 1997 to June 30, 1998. The Division's previous rule enforcement review of the Exchange's compliance program was presented to the Commission on December 21, 1993 ("1993 Review"). Pursuant to Section 8e(a) of the Act, the Division conducts a rule enforcement review of each domestic exchange every two years, to the extent practicable. However, due to the merger of the Commodity Exchange, Inc. with the New York Mercantile Exchange, effective August 3, 1994, the Division delayed commencing this rule enforcement review to allow sufficient time for the two exchanges to merge their compliance staffs and programs into one Compliance Department. In addition, the Division determined not to conduct a rule enforcement review of the Exchange while the Commission was actively considering the Exchange's dual trading exemption petition since the Commission was thoroughly examining the Exchange's trade monitoring system in making its determination.

In the 1993 Review, the Division found that the Exchange had adequate trade practice surveillance and disciplinary programs, and recommended that the Exchange modify its contract size parameter or otherwise modify its computerized surveillance system to ensure that it could more consistently identify potentially violative trades. The Division also recommended that the Exchange consider past disciplinary history when imposing penalties and promptly prepare written decisions of its Appeals Panels. With regard to the Exchange's audit trail program, the Division recommended that the Exchange: (1) develop a program that compares member-recorded execution times for straddles to the Time and Sales Straddle Report and include these data in calculating the Exchange's one-minute trade timing accuracy rate and (2) take action to remind members of their responsibility to use a new trading card at the beginning of each new 30-minute trading interval. The last of these findings is implicated in the findings of this review.⁵

II. METHODOLOGY

During an on-site visit to the Exchange, Division staff interviewed Compliance Department officials, including the Director of the Trade Practice Surveillance unit and the Exchange's Compliance Counsel. Division staff also reviewed Exchange documents that included, among others, the following:

- Computer reports and other documentation used routinely in the conduct of trade practice surveillance;
- All trade practice investigation and disciplinary action files for cases closed during the target period;
- Trade practice investigation and disciplinary action logs;
- Minutes of the meetings of the disciplinary committees held during the target period;
- Compliance manuals and guidelines; and
- Trading card and order ticket review logs.

The Division provided the Exchange with the opportunity to review and comment on a draft of this report on June 16, 1999. On June 24, 1999, Division staff conducted an exit conference with COMEX officials to discuss the report's findings and recommendations.

III. CURRENT FINDINGS AND RECOMMENDATIONS

A. Recordkeeping - Order Tickets and Trading Cards

Findings:

- The Exchange maintains an adequate program for conducting order ticket reviews and Exchange members and firms generally have a high level of compliance with order ticket requirements.
- Exchange members are reviewed at least once a year for trading card recordkeeping compliance and the Exchange re-reviews members who fail any element of a trading card review. This resulted in the Exchange examining a large number of trading cards during the target period.
- The Exchange successfully integrates its recordkeeping reviews with its trade practice surveillance program. Investigation logs and investigation reports indicated that trading cards are routinely reviewed during trade practice investigations. However, a substantial number of investigation files did not include work papers documenting the review.
- Although members generally demonstrated a high level of compliance with a number of trading card recordkeeping requirements, member compliance fell below an acceptable level for several important recordkeeping standards, addressed below in the Division's recommendations.

Recommendations:

- The Exchange should increase the required trading card compliance level from 85 percent to 90 percent, similar to its benchmark for order ticket compliance, and increase its summary fines for trading card violations. The Exchange also should issue a notice to members reminding them of their responsibility to: (1) use a new trading card at the beginning of each new 30-minute trading interval; (2) record the hour, as well as the minute, of all trades on a trading card; (3) identify trades executed during the opening and closing trading periods; and (4) submit trading cards to the Exchange or a clearing member within 15 minutes after the end of each half-hour trading interval.
- The Exchange should ensure that work papers documenting trading card reviews are included in investigation files when trading card reviews are performed during the course of a trade practice investigation.

B. Trade Practice Surveillance Program**Findings:**

- The Exchange maintains an adequate trade practice surveillance program primarily through the utilization of floor surveillance and automated surveillance.
- The Exchange's concerted effort to hire experienced staff resulted in the hiring of six investigative analysts who possess relevant industry and surveillance experience.
- Trade practice investigations were generally thorough, well analyzed, and adequately supported by documentation. The Exchange requires that closeout memoranda be written within three weeks of a closeout sign-off sheet. However, several closeout memoranda were written more than three weeks following the date of the closeout sign-off sheet.
- The investigations that were open longer than four months involved complex fact patterns and required numerous document requests. In addition, investigations often were expanded beyond their original scope.

Recommendation:

- The Exchange should take action to ensure that investigation closeout memoranda are completed within three weeks of investigation closeout sheets.

C. Disciplinary Program**Findings:**

- COMEX generally maintains an adequate disciplinary program.
 - Disciplinary matters are promptly referred to a disciplinary committee and findings appear to be supported by the evidence.
 - In one instance, 17 months passed between the date when a complaint was issued and the date that a hearing was held and 13 months passed before a hearing decision was issued. The case was appealed and an appellate decision was not issued until four and one-half months following the appellate hearing.
 - Fines totaling \$115,000 and membership suspensions totaling 370 days were imposed against five members for trade practice violations. Although the penalties imposed appeared reasonable relative to the conduct being sanctioned and also appeared to take into account members' past disciplinary histories, the Exchange did not order restitution in cases in which customer harm was determined.
 - Summary fines totaling \$14,150 were imposed for trading card recordkeeping and trade timing violations.
- Recommendations:**
- The Exchange should order restitution in all settlements and disciplinary decisions where the amount of customer harm can be determined.
 - The Exchange should take action to ensure that Adjudication Committee hearings are held promptly after a complaint is issued and that Adjudication Committee and Appeals Committee decisions are issued in a more timely manner.

IV. AUDIT TRAIL COMPONENTS: ORDER TICKETS AND TRADING CARDS-

COMMISSION REGULATIONS 1.35 (a-1) (2)-(4) and 1.35(d)

Pursuant to Commission Regulation 1.35(a-1)(2), each exchange member or its designated person receiving a customer's order on the floor must prepare a written record of the order in non-erasable ink, including the account identification and order number. The member then must timestamp the order to reflect the date and time, to the nearest minute, that it is transmitted to or received on the exchange floor. When the execution price is reported from the floor, the order must be time-stamped again, pursuant to Regulation 1.35 (a-1)(4). COMEX Rule 4.81 requires member compliance with these requirements.

Commission Regulation 1.35(d) requires that trading members record information for all transactions on trading cards or other records, including the member's name, opposite member's identification, clearing member's name, date, execution time, commodity, future, quantity, price and delivery month. Further, members recording purchases and sales on trading cards must record such purchases and sales in non-erasable ink, in exact chronological order of execution, on sequential lines of the trading card without skipping lines between trades, and must cross out any remaining lines on the trading card. Trades made during an exchange's opening and closing periods also must be separately identified.

In addition, Commission Regulation 1.35(d) requires that trading cards contain pre-printed identification information and sequence numbers to distinguish one member's cards

from another's, to permit the sequencing of cards and to differentiate each card prepared by a member from such other cards for no less than a one-week period. Trading cards also must be collected by the exchange or the pertinent clearing member within 15 minutes of designated trading intervals not exceeding 30 minutes beginning with the opening of each trading session, and each member must use a new trading card at the beginning of each 30-minute interval. COMEX Rule 4.80 requires member compliance with these requirements.⁶

The COMEX trading card is a three-ply card. To comply with the collection requirement, the original top ply is deposited at a designated Exchange collection point and time-stamped by an Exchange representative. It is then routed to the appropriate primary clearing member ("pCM"), who is responsible for its retention.⁷ One of the two other copies is required to be maintained by the floor member.

The Exchange conducts a routine review of floor order tickets and a routine review of branch office order tickets to assess compliance with the aforementioned order ticket requirements. Separately, the Exchange evaluates members' compliance with trading card requirements by conducting routine reviews of trading cards, which the Exchange refers to as "audit trail reviews." The Division examined the results of the Exchange's order ticket and audit trail reviews completed during the target period, and conducted an independent review of floor order tickets and randomly selected samples of trading cards to assess member compliance with Exchange rules and Commission regulations.

A. Floor and Branch Order Ticket Reviews

In January 1997, the Exchange began conducting bimonthly, rather than quarterly, order ticket reviews. A Compliance Department supervisor or manager selects one broker group for review which results in the opening of a floor order ticket review and a subsequent branch office order ticket review. With respect to floor order ticket reviews, the Exchange requires that a minimum of 30 orders be reviewed from a day within the relevant month in which the selected broker group has significant trading volume. If the Exchange determines that the broker group has sufficient activity on a single day in a single commodity, then orders in that commodity for the selected day are the focus of the review. If a single day's business or the activity in a single commodity is insufficient to provide the minimum required sample, additional trade dates and/or commodities are selected.

A Compliance Department analyst examines each order for the required account identification information and timestamps.⁸ All filled or partially filled orders are required to have entry and exit timestamps, while unfilled or canceled orders are required to contain at least an entry timestamp. As an adjunct to the review, a sample of the filled orders also are matched to the corresponding trades on the executing broker's trading cards, which are requested as part of the order ticket review, to determine if the manually recorded trade execution time on the card is consistent with the order ticket's entry and exit timestamps.⁹

Upon the conclusion of the floor order ticket review, a branch order ticket review is initiated. The analyst, in consultation with a manager or supervisor, selects one group of order tickets for certain futures commission merchants ("FCMs") from the orders received from the broker group and requests corresponding branch orders. The analyst conducts a review similar to that performed for floor order tickets for between 10 and 15 of the branch order tickets. In addition, the analyst examines the timestamps on the branch orders in conjunction with trading card times and time and sales prints to ensure that they are chronologically consistent, and compares the branch order account identifier with the floor order account identifier to ensure that they are consistent. In April 1998, the Exchange increased the required floor and branch order ticket recordkeeping compliance level from 85 percent to 90 percent.

The Division's review of the Exchange's floor order ticket reviews completed during the target period revealed that the Exchange examined a total of 2,150 floor order tickets.¹⁰ The Exchange found that of the 2,150 order tickets examined, 2,078 (97 percent) reflected account identification and 2,023 (94 percent) contained appropriate timestamps. The Exchange completed four of the six bimonthly branch order ticket reviews opened during the target period and examined 45 branch order tickets, 44 (98 percent) of which reflected account identification and 41 (91 percent) of which contained appropriate timestamps.

In addition to reviewing the results of the Exchange's floor and branch order ticket reviews, Division staff independently reviewed the 102 floor order tickets that comprised the Exchange's January 1998 floor order ticket review and concurred with the Exchange's findings.¹¹ Specifically, all of the 66 filled order tickets bore an account identifier and 60 (91 percent) of the filled order tickets contained appropriate timestamps. All of the unfilled orders also complied with the timestamping requirements, containing at least an entry time. However, nine of the 36 unfilled orders (25 percent) did not contain an account identifier. Exchange staff met with the responsible broker and the clearing firm to clarify the proper account identification procedures and issued warning letters.

B. Audit Trail Reviews

1. Exchange Procedures and Results

In addition to the bimonthly order ticket reviews, the Exchange conducts a monthly review of trading cards for member compliance with COMEX Rule 4.80. As noted above, the trading card review is called the audit trail review. To ensure that each member is examined at least once a year for trading card compliance, the Exchange organizes its trading population into 12 groups evenly distributed among its PCMs.¹² Each month, the Exchange randomly selects 30-35 members from its PCMs to comprise a sample for an audit trail review. At least five more members are selected for review from the following computer reports: the Broker vs. Price Change Register Trade Time Comparison Report ("Broker vs. PCR Report"),¹³ the Broker vs. Broker Report,¹⁴ and the Broker On-Time Trade Summary Report.¹⁵ Those members with the highest noncompliance level are selected. In addition, in July 1997, the Exchange instituted a policy of re-reviewing all members who failed any element of a prior audit trail review.¹⁶

Within the group selected for an audit trail review, the Compliance Department reviews a subgroup for compliance with the collection requirement of COMEX Rule 4.80(g). Rule 4.80(g) requires that within 15-minutes after the end of each half-hour bracket, floor members submit the original top ply of each trading card used during the bracket to the members' PCM or deposit the card at a designated Exchange collection point.¹⁷ This subgroup includes all members selected for an audit trail review from the various computer reports, as described above. To test for collection timeliness, Compliance Department staff examines approximately 15 trading cards for each of the selected members to compare the timestamp on the back of a trading card to trade times manually recorded on the front of the trading card. The Exchange requires that each trading card be timestamped upon collection as evidence that the trading card is out of the broker's or trader's possession within the required time period.

In order to enforce compliance with all trading card recordkeeping requirements, the Exchange has implemented a summary disciplinary procedure administered by the Compliance Department. If the Compliance Department finds that a member has committed a trading card infraction, i.e., the member's compliance with any of the recordkeeping standards falls below 85 percent, a warning letter is issued. The member will be fined \$100 for a subsequent infraction within a 12-month period, \$500 for a subsequent infraction within an 18-month period, and will be referred to the Business Conduct Committee for another infraction within a 24-month period. For the reasons articulated below, this summary schedule may have to be more stringent in order to increase compliance with some trading card content requirements.

The Division's examination of the 13 audit trail reviews completed during the target period revealed that a large number of trading cards were examined. The Compliance Department reviewed a total of 15,331 trading cards, an average of 1,179 trading cards per month. These audit trail reviews included three reviews that were opened prior to the Exchange's new policy of re-examining those members who performed poorly in prior reviews. A comparison of audit trail reviews disclosed that the Exchange's new procedure resulted in a significant increase in the number of members selected for review each month and the number of trading cards examined.

Specifically, for the three audit trail reviews conducted pursuant to the old procedure, the number of members selected for review was approximately 40 and the number of trading cards examined per review ranged from 386 to 515. In comparison, for the ten audit trail reviews that included the re-review of selected members, the number of members selected for review ranged from 34 to 56 and the number of trading cards examined per review ranged from 1,111 to 1,689.¹⁸

2. Integration of Recordkeeping and Trade Practice Surveillance

The Division found that COMEX successfully integrates its order ticket and trading card reviews with its trade practice surveillance program. If suspicious trading activity is identified, the review is expanded to investigate potential substantive trading violations. Trading cards are also routinely examined during the course of trade practice investigations.¹⁹ During its examination of investigation files, the Division was able to confirm from either investigation logs or investigation reports that Compliance staff routinely review trading cards during trade practice investigations.²⁰ However, the Division could not review the details of these trading card reviews because a substantial number of investigation files did not include work papers documenting the review.

Compliance Department staff also are given a list each month of members whose trading cards will be examined during the next scheduled audit trail review. This apprises staff that may currently be reviewing the activity of a particular member for substantive trading violations of the opportunity to look at additional source documents for that member. These source documents may be relevant to the particular facts of the ongoing investigation or may assist in establishing a pattern of illegal activity. This practice contributed to a successful investigation that resulted in the Exchange fining two members.²¹

3. Division's Independent Trading Card Review

To independently assess member compliance with trading card recordkeeping requirements, Division staff examined 830 trading cards submitted by 20 of the 43 floor members that were part of the Exchange's June 1998 audit trail review. Division staff found that all 830 cards contained the members' names or codes and reflected all entries in non-erasable ink. Of the 830 trading cards, 773 (93 percent) contained the transaction dates. In addition, 820 trading cards (99 percent) were used in sequence and, based on a review of the manually recorded execution times, 95 percent of the trades on the 830 trading cards were recorded sequentially. No lines were skipped between trades on any of the trading cards examined and 789 cards (97 percent) met the requirement that the remaining lines on the trading card be marked through following the last recorded execution. Of the 830 trading cards, 802 (97 percent) indicated the opposite broker, 792 (95 percent) indicated the underlying commodity traded, 807 (97 percent) indicated the contract month, 824 (99 percent) indicated the quantity traded, and 810 (98 percent) indicated trade price.

However, the Division found that there was an unacceptable level of compliance with respect to several important recordkeeping standards. For example, there were 104 trading cards on which more than one bracket was recorded, indicating an 84 percent compliance rate with the requirement that a new trading card be used at the beginning of each designated 30-minute interval.²² In addition, with respect to COMEX Rule 4.80(b)(E), which requires that each trade entry shall clearly and accurately record the time of execution of the trade to the nearest minute, the 20 members whose trading cards were examined had an overall compliance level of 82 percent. In large part, this compliance rate results from members recording only the minute, and not the hour, of execution.

COMEX trading cards contain a box at the top of each card for members to record the hour of the trades recorded on the trading card.²³ The Division, unlike the Compliance Department, will not consider a trade execution time as clear and accurate if the trading card failed to reflect the hour of execution. The Exchange, on the other hand, will consider a trade time as clear and accurate, even if a trading card does not include the hour of trades, if the hour of a trade is ascertainable from other documents that are available to Exchange staff during an audit trail review. The Division does not believe that this satisfies the requirement that members clearly and accurately record the execution time of each trade on a trading card. Accordingly, the Division recommends that the Exchange require that members record, on the space provided on the trading card, the hour of all trades recorded on the card. This would result in a complete, unambiguous time of execution and would not be an onerous burden on members.

The Division further found that trades executed during the opening and closing trading periods were so indicated 84 percent and 81 percent of the time, respectively. Finally, the Division's examination disclosed that 30 percent of the trading cards examined were not timely submitted to a clearing member. Specifically, 570 trading cards (70 percent) of the 830 examined were submitted to a clearing member within 15 minutes after the end of each half-hour bracket as required under COMEX Rule 4.80(g).

C. Conclusions and Recommendations

The Division found that the Exchange maintains an adequate program for conducting order ticket reviews. Floor order ticket and branch order ticket reviews are conducted bimonthly. Based on the Exchange's floor order ticket and branch order ticket reviews, and the Division's independent review of floor order tickets, the Division found that Exchange members and firms generally have a high level of compliance with order ticket content requirements.

With respect to monthly audit trail reviews, the Exchange has implemented procedures to ensure that each member is reviewed at least once a year for trading card recordkeeping compliance. This resulted in the Exchange examining a large number of trading cards during the target period. In addition, the Exchange's policy of re-reviewing members who fail any element of an audit trail review has significantly increased the number of members selected for review each month and the number of trading cards examined.

The Division also found that COMEX successfully integrates its recordkeeping reviews with its trade practice surveillance program. The Division was able to confirm from detailed investigation logs and investigation reports that trading cards are routinely examined during the course of trade practice investigations. However, a substantial number of investigation files which indicated that member(s) trading cards had been examined during a trade practice investigation did not include work papers documenting these trading card reviews. Thus, the Division could not examine the details of these reviews.

The Division's independent examination of 830 trading cards belonging to 20 members disclosed that while members generally demonstrated a high level of compliance with a number of trading card recordkeeping requirements, the Exchange must take action to improve member compliance with several important recordkeeping standards. First, the Division's review disclosed that 30 percent of the trading cards were not submitted to a clearing member within 15-minutes after the end of each half-hour bracket, as required under COMEX Rule 4.80(g); second, a large number of trading cards reflected only the minute of trades recorded on a trading card, not the hour, despite the Exchange's requirement that a clear and accurate execution time be recorded for each trade; and third, trades executed during the opening and closing trading periods were only indicated as such 84 percent and 81 percent of the time, respectively. The Division also found that 16 percent of the trading cards it examined did not satisfy the requirement that a new trading card be used at the beginning of each designated 30-minute interval. This deficiency also was identified during the 1993 Review.

Based on these findings, the Division believes that the Exchange should consider ways to improve members' compliance with certain trading card recordkeeping requirements. In doing so, the Exchange should consider, among other things, increasing the required compliance level to 90 percent. This would be consistent with the Exchange's practice regarding order ticket compliance. The Exchange also should consider increasing its fining schedule for trading card violations.

Based on its review, the Division recommends that the Exchange:

- Increase the required trading card compliance level from 85 percent to 90 percent, similar to its benchmark for order ticket compliance, and increase its summary fines for trading card violations. The Exchange also should issue a notice to members reminding them of their responsibility to: (1) use a new trading card at the beginning of each new 30-minute trading interval; (2) record the hour, as well as the minute, of all trades on a trading card; (3) identify trades executed during the opening and closing trading periods; and (4) submit trading cards to the Exchange or a PCM within 15 minutes after the end of each half-hour trading interval.
- Ensure that work papers documenting trading card reviews are included in investigation files when trading card reviews are performed during the course of a trade practice investigation.

V. TRADE PRACTICE SURVEILLANCE - SECTION 5a(8) AND 5a(b) AND

COMMISSION REGULATIONS 1.51(1), (2), (4), (5) AND (6)

Section 5a(a)(8) of the Act requires each exchange to enforce the bylaws, rules, regulations, and resolutions made or issued by it, the governing board or any committee. Section 5a(b) of the Act requires each exchange to maintain and to use a system to monitor trading to detect and deter violations of the exchange's rules committed in the making of trades. Under Section 5a(b)(1), such a system must include, among other things, trade practice surveillance systems capable of reviewing, and used to review, trade data in order to detect violations committed in making trades and executing customer orders; floor surveillance; and the commitment of resources necessary for a trade monitoring system to be effective in detecting and deterring trade practice violations, including adequate staff to develop and prosecute disciplinary actions.

In addition, Commission Regulation 1.51 has long required that each exchange exercise due diligence in maintaining a continuing program for the surveillance of trading practices on the floor of the exchange; for the investigation of customer complaints and other alleged or apparent violations of the exchange bylaws, rules, regulations and resolutions; and for such other surveillance, record examination, and investigation as is necessary to enforce exchange bylaws, rules, regulations, and resolutions.

A. Staffing

As part of the merger of COMEX and NYMEX, the self-regulatory staffs of the two exchanges were merged into one Compliance Department which is divided into three sections: Trade Practice Surveillance, Market Surveillance, and Financial Surveillance. The Compliance Department is led by the Vice President of Compliance, who has served in this position since the NYMEX/COMEX merger in August 1994. Prior to the merger, the Vice President served as Vice President of Compliance at NYMEX. The Trade Practice Surveillance unit consists of 21 persons, including a Director.²⁴ The Director has ten years of trading floor experience, including eight years as a COMEX member. Prior to being appointed Director in October 1996, he served as a Compliance Department supervisor. The Director has overall responsibility for the investigation and prosecution of rule violations. The Trade Practice Surveillance unit is supported by one Compliance Counsel and two Associate Counsels. The Compliance Counsel, who has been with COMEX for almost ten years, oversees the legal aspects of all trade practice investigations and coordinates all phases of the Exchange's disciplinary proceedings. The Vice President, the Compliance Counsel, and the Director ultimately determine whether evidence supports the Compliance Department recommending that an investigation be referred to a disciplinary committee.

The Compliance Department's Trade Practice Surveillance staff also includes one supervisor, four managers, eleven analysts, and three clerks. The supervisor and managers, who report to the Director, oversee investigations and provide general guidance to the analysts and clerks. They also contribute to the process of determining whether an investigation should be referred to a disciplinary committee. Analysts are responsible for reviewing computerized reports, including the Exchange's trade register, conducting floor surveillance and order ticket and audit trail reviews, and investigating potential violations detected from the review of computerized reports or which are referred by other sources, such as customers, members, and the Commission. The clerks perform administrative functions and conduct certain audit trail review procedures.

During the first half of 1998, the Exchange identified a pattern of high employee turnover in which the Exchange hired entry level staff, invested a great deal of time in training them as analysts, and then many would leave after two or three years. To remedy this situation, the Exchange began a concerted effort to hire experienced employees for its Trade Practice Surveillance staff. As part of this effort, six analysts were hired in 1998 who possessed demonstrated industry knowledge, surveillance experience, or other relevant experience, and an interest in enforcement and regulation.²⁵ For example, four of the newly hired analysts possessed past trading floor and surveillance experience and two had a law enforcement/criminal justice background. Of the four analysts with trading floor and surveillance experience, one has 20 years of experience in the futures industry, including 14 years of trading floor experience; one has 11 years of floor trading experience; one has five years prior experience as a National Association of Securities Dealers examiner; and one has ten years of surveillance experience with the Chicago Mercantile Exchange.

B. Automated Trade Practice Surveillance

The Exchange's trade practice surveillance program relies upon several automated reports including the Daily Brokerage Recap ("DBR"), the Exchange's trade register; exception reports generated by the Exchange's automated trade practice surveillance system, the Trade Surveillance Exception Reporting System ("TSER"); and specialized surveillance reports. All of these reports and the PCR are available to Compliance Department staff on-line through the Exchange's COMSTAR system. The COMSTAR system, implemented

in 1996, allows analysts to view all pertinent surveillance reports on their desktop computers and to sort the data in spreadsheets. This ability to view and sort data on-line enhances the volume of trade information that can be reviewed. All of the automated reports also are available in hard copy.

1. Daily Brokerage Recap

The DBR contains each matched and unmatched trade and reflects the executing broker, clearing member, trade date, contract, month, quantity, price, opposite member and clearing member, account number, minute of execution, CTI code for each side of a trade, trade identification number, strike price, put or call, and premium.²⁵ The DBR sorts trading data in two ways: (1) by executing broker and clearing member and (2) by executing broker and time of execution.

Analysts review the DBR on one randomly selected day each week and on particularly volatile days. The review covers all trading activity for the entire day. The Exchange maintains a log of the weekly DBR reviews which includes the review date, analyst, supervisor or manager, trade date, and any comments. The Division reviewed sample pages from the DBR log and found that the reviews were conducted as scheduled. During the target period, four investigations were initiated based on a DBR review. Three of these investigations involved possible prearranged or noncompetitive trading and the other investigation concerned possible fictitious trading.

2. Exception Reports

The Exchange's automated trade practice surveillance system, TSER, generates several daily reports designed to isolate suspicious trading activity. TSER reports are generated from data contained in the DBR with selection parameters adapted for each specific category of potential violation. These parameters can be modified by Compliance Department staff, as necessary. The Exchange uses these reports to identify possible instances of trading ahead, withholding orders, disclosing orders, accommodation trading, prearranged trading, improper cross trading and money passing schemes. The reports also are used to expand the scope of an investigation where potential violative trading patterns may have been found.

The Trading Ahead Report reflects trades where the executing broker trades for his or her own account, or an account that he or she controls, and the broker's trade is on the same side of the market within five minutes, before or after the customer's trade, and at an equal or better price than that received by the customer. The Preferential Trading Report is a TSER report designed to detect instances in which a member may be withholding customer orders from the market or disclosing the terms of orders for the benefit of another member. The system searches for any trades where the executing broker executes a customer trade opposite another member's personal trade. It then sorts the opposite member's trades for instances where such member's trades were on the same side of the market as the customer order, within five minutes before or after the customer trade, and at an equal or better price than that received by the customer.

The Prearranged Trading Report, another TSER report, is designed to detect three potential types of prearranged trading. First, the report identifies possible violations involving a single customer order where the executing broker may have traded indirectly opposite the order through the accommodation of another member. Second, the report identifies possible violations involving two customer orders and an accommodating member. Third, the report identifies possible violations involving three members. In the latter instance, the system selects instances where a broker traded indirectly opposite a customer order through the accommodation of two other members, i.e., where the third member trades for his or her personal account with both brokers, executing a wash trade to accommodate the other brokers.

The TSER system also generates the Payback Report, which is designed to detect members' potential prearranged trading intended to facilitate a money pass between members. The report reflects trades between the same executing and opposite brokers who, on the same day, trade at different prices for their personal accounts so that money passes between them. Finally, the TSER system produces a summary report, Total of Members' Appearances on Exception Reports Over Previous Two Months ("Summary Report"), that identifies members and their frequency of appearances on other TSER reports during the previous two-month period.

All of the TSER reports, with the exception of the Summary Report, are reviewed by analysts daily. The Summary Report is reviewed on an as needed basis. While each TSER report is generally assigned to the same analyst for daily review, assignments are rotated periodically so that each analyst becomes proficient in reviewing all of the exception reports. Analysts review their assigned exception report and record any findings on the relevant exception log.²⁷ The analyst generally looks for a pattern indicative of illegal trading activity, the frequency of a member's appearances on the exception reports, and the size of the trades. In addition, analysts attempt to identify suspicious trades for follow-up review, even if such trades are not part of a pattern of suspicious trading activity. Analysts also may review exchange records relating to a particular suspicious trade. If an analyst determines to request underlying trading documents, an investigation is opened. During the target period, 36 investigations were opened based on Exchange review of various TSER reports, as detailed below.

3. Specialized Computer Reports

Exchange staff also review three specialized computer-generated reports which detail certain activity. These reports are not designed as exception reports. The first of the reports is the Crossed Trades Report, which is reviewed by a Compliance Department analyst weekly to detect possible violations of the Exchange's prohibition against members crossing their customer orders against their personal accounts. One investigation was initiated from this report during the target period. The other two specialized reports, the Broker Unmatched Trade Report and the Correction Audit Trail Report, are reviewed by the Exchange's Trade Audits Department.²⁸

C. Floor Surveillance

Trade practice analysts routinely observe trading at the open, the close, and at one random time during the trading day. At the beginning of each month, a schedule is prepared showing analysts assignments. One analyst is assigned to cover the opening trading period from 8:00 a.m. to 8:40 a.m. This same analyst, along with all other available analysts, observes the closing trading period from 1:50 p.m. until the end of the post-settlement close of the gold market, sometime after 2:30 p.m. The Compliance Department also assigns an analyst to observe trading activity for approximately 20 minutes during the trading day. All analysts are encouraged to observe the trading floor at random times during the trading day, especially during busy periods. In addition, the Exchange increases floor surveillance when warranted by extraordinary market conditions.²⁹

If an analyst observes an apparent trading violation while on the floor, he or she is required to document immediately their observations in writing, initial the notes, and, if possible, promptly timestamp the notes at a time clock on the trading floor. All analysts also are required to fill out a Weekly Floor Observation Sheet detailing their weekly floor surveillance activities. The analysts indicate for each trading day the time they were present on the floor, the market(s) observed, and observations.³⁰ Analysts also discuss any unusual observations with the Compliance Department supervisor, a manager, or Compliance Counsel to determine if further action should be taken.

The Exchange uses floor surveillance observations to: (1) detect violative transactions, including noncompetitive trading and improper cross trading; (2) determine the physical location of members relative to other members; (3) determine members' affiliations with other members; (4) document various floor trading practices; (5) identify trading patterns that are unusual for particular members; and (6) deter members from engaging in illegal trading activity, including noncompetitive trading and trading before the open or after the close. Additionally, floor surveillance provides the floor population an opportunity to interact with Compliance Department staff on occasions when Exchange rules may need clarification. One investigation was initiated during the target period as a result of floor surveillance. Based on floor observations, Compliance Department staff questioned whether a suspended member, who was permitted to act in a clerical capacity for his brokerage company, was actually trading for his own account. A follow-up investigation found that the member was not trading for his personal account.

D. Adequacy and Timeliness of Investigations

1. Adequacy of Investigations

The Compliance Department initiates and conducts investigations when information obtained indicates that a possible violation of Exchange or Commission rules may have occurred. That information may be derived from floor surveillance, reviews of TSER and DBR reports, or from external sources that include member, customer, and anonymous complaints. Investigations also may be initiated as a result of referrals from the Commission or the National Futures Association ("NFA"). Once a decision has been made to open an investigation, an analyst and investigation number are assigned to the matter and it is recorded into an investigation log maintained by the Compliance Department. The Exchange's investigation log includes, for each investigation, the date it was opened, the member being investigated, the nature of the investigation, and the initials of the analyst assigned to the investigation. Each month the Exchange prepares a document entitled "COMEX Division Open Case List" which includes, among other information, investigations opened during the current month, and investigations that have been ongoing for two to four months or more.³¹

At the initiation of an investigation, the analyst will request documentation from the members involved by sending a form letter, which is either hand delivered or accepted in the Compliance Department by the addressee or his/her designee. In either instance, the recipient signs a copy of the letter to acknowledge receipt. A signed timestamped copy is kept in the investigation file. Upon receipt of the requested documentation, the analyst reviews the documents along with other records, including relevant PCRs and DBRs. While an alleged violation may determine the direction and general scope of an investigation, an investigation may be expanded to include other potential violations that become evident during the course of the general investigation.

During the target period, Compliance opened a total of 59 investigations. Of these, 46 were internally generated by the Compliance Department, including 29 (63 percent) through review of the Prearranged Trading Exception Reports; six (13 percent) through review of the Trading Ahead Exception Reports; one (two percent) through review of the Preferential Trading Exception Reports; and four (nine percent) through review of Daily Brokerage Recaps. Six (13 percent) additional investigations were developed by the Compliance Department based on reviews of order ticket, trading card, cross-trade, correction slip, and out-trade correction procedures. Of the remaining 13 investigations, six were opened based on customer complaints; four were initiated because of member complaints and/or referrals; one was opened due to an observation made on the trading floor; one (8 percent) was initiated due to a member's appeal of floor fines; and one (8 percent) was based upon a Division referral concerning possible trading ahead of customer orders.³²

The Division reviewed all 58 of the Exchange's trade practice investigations that were closed during the target period, including two Division referrals. The investigations reviewed included, among others, investigations of possible trading ahead, prearranged trading, and other non-competitive trading, as well as customer complaints.

The Division found that Exchange staff generally conducted appropriate analyses and that investigations were thorough and well documented. Investigation files contained relevant documentation, including copies of trading cards, order tickets, computerized exception reports, DBRs, PCRs, and correspondence. When interviews were conducted as part of an investigation, the interview date was recorded in the investigative file. Tape recordings of interviews are generally not included in investigation files, but are maintained within the Compliance Department.

The Exchange considers an investigation closed as of the date a discussion takes place between the Director, the analyst that worked on the case and, in most instances, the supervisor or manager who supervised the investigative process. Simultaneous with a determination that a case be closed, a "closeout sign-off sheet" is prepared by the analyst and signed by the Director. Investigative files examined by Division staff revealed that the closeout sign-off sheets contained relevant information concerning the disposition of the case, as well as pertinent facts. The rationale behind the decision to close an investigation with no action, to issue a warning letter, or to refer the matter to a disciplinary committee also is included. The subject(s) of the investigation are notified of the determination in writing within 48 hours of the closeout sign-off sheet's completion. Likewise, in the case of a customer initiated investigation, the complainant is notified within the same period of time. At this point the investigation is completed and no further analysis takes place.

The analyst then prepares a "closeout memorandum" describing the details of the investigation, including how it was initiated, the facts developed during the course of the investigation, and the staff's conclusions and recommendations. During December 1997, the Compliance Department implemented a policy requiring that a closeout memorandum be completed within three weeks of the closeout sign-off sheet.³³ However, the Division's review of investigations closed after this policy was implemented disclosed that closeout memoranda are often written more than three weeks following the date of the closeout sign-off sheet. The Division found 16 instances in which closeout memoranda

were written anywhere from one month to 15-months following a closeout sign-off sheet.³⁴ These memoranda should be completed and available in a much more timely fashion.

2. Timeliness of Investigations

The Division found that the Exchange's investigations were generally completed in a timely manner. Of the 58 trade practice investigations closed during the target period, including 25 opened prior to the start of the period, 21 (36 percent) were completed in four months or less. Another 17 (29 percent) were closed within four to six months, and 20 (34 percent) were closed within six months to one year. Of the 33 investigations opened and closed during the target period, 16 (48 percent) were completed within four months, seven (21 percent) were closed between four and six months, and 10 (30 percent) were closed within six months and one year. At the beginning of the target period, 27 investigations were open. By the close of the target period, 25 of these investigations were closed, including three that were referred to a disciplinary committee. Of these 25 closed investigations, five (20 percent) were completed within four months, 10 (40 percent) were closed between four and six months, and 10 (40 percent) were closed between six months and one year.

As indicated, with the exception of two investigations, there were no investigations open beyond one year.³⁵ Those investigations that were open between six months and one year were justifiably open for that length of time. These investigations involved complex fact patterns, required numerous document requests and interviews, and several were expanded beyond their original scope. For example, Investigation No. 03-924-100196, which was open just under 12 months, initially involved potential pre-arranged and non-competitive trading among three members. The investigation was later expanded to include two more members. Documents were requested from all five members' PCMs. As part of the investigation, the Compliance Department reviewed trading activity covering six months and numerous trading cards, order tickets, DBRs, PCR's, pit slips, and Time and Sales Straddle Reports. In addition, all five members and an Exchange floor representative were interviewed. Compliance Department staff also had discussions with several PCMs. The Exchange found no indication of additional violations. Ultimately, three members received warning letters.

Twenty-six investigations opened during the target period remained open at the end of the target period. Of these, 14 had been open for less than four months, seven had been open between four and six months, and five had been open for more than six months.

During the target period, the Exchange initiated six investigations based upon customer complaints and completed all of them by the close of the target period. Four of the customer complaints involved alleged bad fills and two involved settlement price disputes. Five of the customer complaints were closed in less than four months, and one was closed in just over four months. The Division found that the investigations of these customer complaints were timely, thorough, and well documented.

E. Conclusions and Recommendations

The Exchange maintains an adequate trade practice surveillance program through the utilization of floor surveillance and automated surveillance. The Exchange's effort to hire experienced staff resulted in the hiring of six analysts during 1998 who possess relevant industry and surveillance experience. The Division found that trade practice investigations were thorough, well analyzed, and adequately supported by documentation. Each investigative file contained, among other records, trading cards, order tickets, PCR's, DBRs, copies of correspondence, a listing in chronological order of requests for documentation and scheduling of interviews, an investigation closeout sign-off sheet, warning letters, and a closeout memorandum. The Exchange requires that a closeout memorandum be prepared within three weeks of a closeout sign-off sheet. However, the Division discovered several instances when the gap between these processes exceeded three weeks and has ranged from one-month to 15-months.

Although several investigations remained open up to a year, the Division found that these investigations involved complex factual patterns and required numerous document requests and interviews. Nevertheless, the Division believes that the Exchange should continue to strive to improve the timeliness of its investigations.

Based on its review, the Division recommends that the Exchange :

- Take action to ensure that investigation closeout memoranda are completed within three weeks of investigation close-out sheets.

VI. DISCIPLINARY ACTIONS - SECTION 5a(b) AND COMMISSION

REGULATION 1.51(a)(7)

A. Introduction

Under Section 5a(b) of the Act, an exchange's trade monitoring system must include appropriate disciplinary actions and meaningful penalties against violators. In addition, Commission Regulation 1.51(a)(7) requires that each exchange use due diligence in maintaining a continuing affirmative action program which results in prompt, effective disciplinary action for violations of exchange rules. When reviewing disciplinary programs, the Division considers, among other factors, the support for findings made in disciplinary actions, the adequacy of sanctions imposed, and the timeliness of the procedures.³⁶ The Division also assesses compliance with Commission Regulations 8.09 and 8.17, which require, respectively, that disciplinary committees review investigation reports in a timely manner and issue either a notice of charges or a written decision stating the reasons why no further action will be taken and that hearings be convened promptly after reasonable notice.

COMEX and NYMEX members and member firms are subject to the same disciplinary rules, hereinafter referred to as "Disciplinary Rules." As described below, the Business Conduct Committee ("BCC") and the Adjudication committees are divided into COMEX panels and NYMEX panels. For purposes of the Division's discussion and analysis, unless otherwise noted, all references to a committee or panel are to a COMEX committee or panel.

B. COMEX Disciplinary Committees

COMEX has three primary disciplinary committees: the BCC, the Adjudication Committee, and the Appeals Committee. In addition, Disciplinary Rules 8.21 and 8.22 authorize the Exchange's Floor Committee to impose summary fines, not exceeding \$5,000, for violations of Exchange rules concerning matters such as clerk registration, decorum, practices disruptive of or inconsistent with orderly trading procedures, and the timely submission of accurate report records or similar matters for clearing or for verifying each day's transactions. The Floor Committee also is responsible for issuing warning letters and imposing and collecting fines with respect to the Exchange's recordkeeping summary disciplinary program administered by the Compliance Department.³⁷

The BCC is divided into a COMEX Panel and a NYMEX Panel. The COMEX Panel consists of a Chairman, who is a NYMEX Division member, nine regular committee members, and four alternates.³⁸ The BCC is responsible for determining whether a member or member firm should be prosecuted for violations of Exchange or Commission rules. As described below, the BCC also is authorized to enter into settlement agreements in conjunction with the initiation of disciplinary proceedings.

The Adjudication Committee is equally divided into four hearing panels, two COMEX Hearing Panels and two NYMEX Hearing Panels. The Adjudication Committee is chaired by a NYMEX member who is responsible for, among other things, appointing ten regular committee members for each Hearing Panel and designating alternates.³⁹ The Hearing Panels conduct hearings, determine whether rule violations have occurred, and levy sanctions for any violations found to have been committed. The Hearing Panels also can enter into settlement agreements with respondents. Appeals from a Hearing Panel decision are heard by the Appeals Committee, whose members are selected by the Appeals Committee Chairman. In the event of an appeal, the Chairman appoints an Appeals Panel of three committee members, one of whom must be a COMEX member.⁴⁰

All members selected to serve on an Exchange disciplinary committee must be approved by the Board of Directors ("Board"). With respect to conflict of interests, no person may serve in any of these capacities regarding a specific matter if that person has any direct financial, personal, or other interest in the matter under consideration. In addition, any

person who has participated in any prior stage of the disciplinary process is not eligible to serve in a higher decisional capacity for the same proceeding. Furthermore, any person who, within the prior three years, has been found to or entered into a settlement agreement finding that he or she committed a disqualifying disciplinary offense, is prohibited from serving on any of the bodies involved in the disciplinary process.⁴¹

C. Disciplinary Procedures

If the Compliance Department determines that there is a reasonable basis to believe that a rule violation has occurred, an investigation report is prepared and delivered to the BCC. The investigation report includes the reasons that an investigation was initiated, the relevant facts, and the Compliance Department's conclusions and recommendations. At anytime prior to the submission of an investigation report to the BCC, the Compliance Department may negotiate a settlement offer. An individual or firm may agree, without admitting or denying a violation, to a settlement agreement that provides for any combination of the following sanctions: a cease and desist order, a censure, or a fine not exceeding \$5,000 for each rule violation alleged. Any such settlement agreement is subject to BCC approval.⁴²

If no such settlement agreement is reached, a copy of the investigation report is furnished to the individual or firm that is the subject of the report. The subject then has five days following receipt to submit a written statement and supporting documentation to the BCC for consideration.⁴³ The BCC meets monthly to review investigation reports and related matters. Although individuals and firm representatives are permitted to appear and make oral presentations before the BCC, the presentation is limited to matters raised in the subject's written response to the investigation report.⁴⁴ If the BCC concludes that a reasonable basis exists for finding that a rule violation has occurred, the BCC will take any one of the following actions: (1) return the matter to the Compliance Department for further investigation; (2) issue a warning letter; or (3) direct the Compliance Department to issue a complaint.⁴⁵ The BCC also may consider settlement offers concurrent with or subsequent to consideration of an investigation report and may enter into such an agreement that could provide for any combination of the following sanctions: a cease and desist order, a censure, a fine not exceeding \$25,000 per rule violation, a suspension not exceeding three months per rule violation, or expulsion.⁴⁶

When the Compliance Department issues a complaint, it is delivered to the respondent,⁴⁷ filed with the Exchange's Hearing Registrar, and forwarded to the Adjudication Committee, along with any written response and/or request for a hearing from the respondent, and any written reply from the Compliance Department.⁴⁸ The Chairman of the Adjudication Committee assigns the case to one of the two COMEX Hearing Panels to hear and decide the matter. The Hearing Panels also may consider settlement offers, which are directed to the opposite COMEX Hearing Panel for consideration, and which, if approved, are subject to approval of the Board. The types of sanctions to which a COMEX Hearing Panel may agree as a result of a settlement agreement are similar to those which may be agreed to by the BCC, except that fines may be larger (with a ceiling of \$250,000 per violation) and there is no three-month limit on the length of a suspension.⁴⁹

If the respondent admits or fails to deny any rule violation charged in the complaint, the originally assigned Hearing Panel must impose a penalty for each violation and so notify the respondent within 45 days after receipt of the admission or failure to deny. If the respondent has submitted an answer denying the rule violations charged, and has not requested or has waived a hearing, the Hearing Panel must make its decision based on documents filed by the Compliance Department and the respondent, and render a written decision in the same manner as if a hearing had been conducted.⁵⁰

In the event that a disciplinary matter proceeds to a hearing, the Hearing Panel generally must render a written decision within 45 days after the close of the hearing or the last day on which any post-hearing memoranda were required to be filed. If the respondent is found not to have committed any violation, the written decision must include a summary of the charges and the answer, a summary of the evidence produced at the hearing, and a statement of the findings and conclusions of the Hearing Panel with respect to each charge. If the respondent is found to have committed a violation, the written decision also must include an order stating the penalties imposed and the effective date of such penalties. The sanctions that may be imposed by a Hearing Panel in rendering a written decision are the same as those which may be included in a Hearing Panel settlement agreement, as described above.⁵¹ Unless appealed within 10 days, the Hearing Panel's decision is the final decision of the Exchange and is effective 15 days after delivery to the respondent and the Commission.⁵²

In the event of an appeal, the Appeals Committee Chairman appoints an Appeals Panel to hear and decide the matter. The Appeals Panel may require the parties to make an oral presentation or may decide the appeal on the basis of the written submissions of the parties and the existing record of the proceeding. The Appeals Panel may affirm, reverse, or modify the Hearing Panel's decision, but may not set aside the Hearing Panel's findings of rule violations if those findings are supported by the record. The Appeals Panel's written decision must include, among other things, a statement of findings and conclusions regarding each charge or penalty reviewed. The Appeals Panel's conclusion constitutes a final decision of the Exchange and takes effect 15 days after delivery to the respondent and to the Commission.⁵³

D. Sanctions Imposed

The Division reviewed the Exchange's Disciplinary Register, various disciplinary committee minutes, the Regulation 9.11 disciplinary action notices received from the Exchange reflecting disciplinary actions taken during the target period, and all related Exchange disciplinary files.⁵⁴ During the target period, each of the five members referred to the BCC were sanctioned for various trade practice and recordkeeping violations.⁵⁵ Generally, the penalties were the result of settlement agreements. However, one case resulted from a decision of an Adjudication Committee Hearing Panel and was affirmed by the Appeals Committee during the target period.⁵⁶ The penalties imposed included substantial fines totaling \$115,000, membership suspensions totaling 370 days, and four cease and desist orders.

Specifically, in the Adjudication Committee Hearing Panel decision upheld by the Appeals Committee, a member was fined \$100,000, permanently prohibited from executing customer orders, and suspended for one year for engaging in a pattern of misconduct that included prearranged and noncompetitive trading, fraudulently executing customer orders, and various recordkeeping violations.⁵⁷ In another case, one member was fined \$10,000, ordered to cease and desist from engaging in noncompetitive and prearranged trading and indirectly taking the opposite side of customer orders, and was suspended for five days. The other member involved in this matter was permitted to withdraw from membership. However, the Exchange ordered that if the member reapplies for membership, he must pay a \$5,000 fine prior to submitting a membership application. Neither member was ordered to pay restitution, despite the fact that customer loss was determined by the Exchange to be approximately \$3,175.⁵⁸ The Division believes that the sanctions in these two cases adequately reflected that two of the members had previous disciplinary histories involving prearranged trading.⁵⁹ Finally, in another case, the Exchange fined two members, who were not previous offenders, \$2,500 each and ordered both to cease and desist from engaging in noncompetitive and prearranged trading. Although the Exchange determined that customer loss was at least \$1,350, the brokers were not ordered to pay restitution.⁶⁰ The Division generally found that the sanctions imposed during the target period were appropriate in relation to the rule violations committed and that the sanctions adequately reflected members' prior disciplinary records. However, the Division strongly believes that in those cases where the Exchange can determine customer loss, as it did in the above two cases, the Exchange should order respondents to pay restitution to injured customers.

During the target period, the Exchange also issued a total of 121 warning letters and imposed 36 summary disciplinary fines ranging from \$100 to \$1,000 for trading card and trade timing violations. In this regard, the Exchange issued 72 warning letters and imposed 25 summary fines totaling \$2,900 for various trading card recordkeeping violations. The Exchange also summarily warns and fines members each month whose audit trail accuracy rate falls below 80 percent. Under this program, the Exchange issued 49 warning letters and imposed 11 summary fines totaling \$11,250.

E. Timeliness of Disciplinary Proceedings

Commission Regulation 8.09 requires that an exchange disciplinary committee promptly review each investigation report and, if the committee determines that additional investigation or evidence is needed, promptly direct the Compliance staff to conduct further investigation. Within 30 days of receiving a completed investigation report, an exchange disciplinary committee must either (1) determine that no reasonable basis exists for finding a violation or that prosecution is unwarranted and direct that no further action be taken or (2) determine that a reasonable basis exists for finding a violation which should be adjudicated and direct that the alleged violator be served with a notice of charges.⁶¹ Regulation 8.09 further provides that if a disciplinary committee determines that no reasonable basis exists for finding a violation and directs that no further action be taken, such determination "must be in writing and contain a brief statement setting forth the reasons therefor."

During the target period, the BCC reviewed three investigation reports involving four members. In each instance, the BCC determined during the respective meeting, that a reasonable basis existed to issue a complaint. Thus, the BCC's determinations all were within the prescribed 30-day time period. The Division also reviewed the length of time between the date of BCC decisions to issue charges and the dates complaints were served, the length of time between the date that complaints were issued and the date of a hearing, and the length of time from the conclusion of a hearing until the issuance of a written decision. The Division found that complaints were generally issued within one to two weeks of a BCC determination to do so.

With respect to the commencement of disciplinary hearings and appellate hearings, and the subsequent issuance of a written decision, the Division identified one case in which it believes that the process should have been completed in a more timely manner. As noted earlier, in Disciplinary Case No. 01-782-94, the Appeals Committee affirmed the decision of a Hearing Panel. A complaint originally was issued against four members on June 6, 1994. The charges were settled with respect to three members and a hearing regarding the fourth member was conducted on November 9 and 15, 1995, and February 20 and 22, 1996.⁶² On March 19, 1997, the Hearing Panel rendered its decision and imposed a \$100,000 fine, a one-year suspension of membership privileges, and a permanent prohibition from executing customer orders. The member appealed the Hearing Panel's decision and an Appeals Panel conducted an appellate hearing on December 1, 1997. The Appeals Panel subsequently issued a written decision and order on April 23, 1998.

The Division found that a considerable amount of time lapsed between the date that the complaint was issued and the date that a disciplinary hearing commenced (17 months), and the date that the hearing ended and the Hearing Panel issued its decision (13 months). This delay is inconsistent with Commission Regulation 8.17(a)(3) which requires that disciplinary hearing be conveyed promptly after reasonable notice. Moreover, the Exchange's own rules require that the Adjudication Committee issue a written decision within 45 days after the later of a hearing or the last day any post-hearing memoranda were required to be filed, unless additional time is required due to the complexity of the case.⁶³ The Division recognizes that the case involved a complex factual pattern of 21 different trading sequences among four members, but nevertheless believes that the Exchange must implement procedures to ensure that Adjudication Committee hearings are held promptly after a complaint is issued. Furthermore, the Division also believes that the decisions of the Hearing Panel and the Appeals Committee should have been rendered in a more timely manner.

F. Conclusions and Recommendations

Based upon its review, the Division found that the Exchange generally maintains an adequate disciplinary program. Disciplinary matters are promptly referred to the BCC and findings in cases that proceed for further action appear to be supported by the evidence. The Exchange imposed summary fines totaling \$14,150 for trading card recordkeeping and trade timing violations. In addition, the Exchange imposed non-summary fines totaling \$115,000 and issued membership suspensions totaling 370 days for various trade practice violations. Although the penalties appear reasonable relative to the conduct being sanctioned and take into account members' prior disciplinary histories, the Division believes that restitution should be included in all settlements and decisions where customer harm can be determined to ensure that injured customers are appropriately compensated for losses due to a member's abusive trading activity.

With regard to the timeliness of disciplinary procedures, the Division found one instance in which 17 months passed between the date when a complaint was issued and the date that an Adjudication Committee Hearing Panel held a hearing. In addition, 13 months passed before the Hearing Panel issued a decision. That decision, which imposed substantial sanctions, was upheld by an Appeals Panel. However, the Appeals Panel did not issue its decision until four and one-half months following the appellate hearing. The Division believes that the Exchange should implement procedures to ensure that Adjudication Committee hearings are held promptly after a complaint is issued. In addition, the Adjudication Committee and the Appeals Committee should improve the timeliness of issuing decisions once a proceeding is concluded.

Based on its review, the Division recommends that COMEX:

- Order restitution in all settlements and Exchange disciplinary decisions where the amount of customer harm can be determined.

- Take action to ensure that Adjudication Committee hearings are held promptly after a complaint is issued and that Adjudication Committee and Appeals Committee decisions are issued in a more timely manner.

¹ Rule enforcement reviews prepared by the Division are intended to present an analysis of an exchange's overall compliance capabilities for the period under review. Such reviews deal only with programs directly addressed in the review and do not assess all programs. The Division's analyses, conclusions, and recommendations are based, in large part, upon the Division's evaluation of a sample of investigatory cases and other exchange documents. This evaluation process, in some instances, identifies specific deficiencies in particular exchange investigations or methods but is not designed to uncover all instances in which an exchange does not address effectively all exchange rule violations or other deficiencies. Neither is such a review intended to go beyond the quality of the exchange's self-regulatory systems to include direct surveillance of the market, although some direct testing is performed as a measure of quality control.

² In addition, the Exchange's market surveillance program was evaluated in a separate rule enforcement review presented to the Commission on April 2, 1998.

³ 62 FR 26480 (May 14, 1997).

⁴ Commission staff's examination of the Exchange's surveillance system and disciplinary program with respect to the Exchange's dual trading exemption petition did not include the review of individual investigation and disciplinary case files.

⁵ Section IV.B.3. below includes a discussion of trading card issues.

⁶ COMEX Rule 4.80 also requires that floor members record all trades on trading cards, including customer trades.

⁷ Each member who executes transactions on the floor must be unconditionally guaranteed by a qualified guarantor which is the member's PCM. Although under COMEX Rule 4.80(g) members also have the option of submitting original trading cards to their PCM for timestamping rather than the Exchange, in practice, the vast majority of members submit their trading cards directly to the Exchange.

⁸ The Exchange considers a customer's account number or a unique code traceable to that account an acceptable account identifier.

⁹ Section 3a(b)(2) of the Act establishes that an audit trail system of each exchange must accurately record the one-minute execution times of trades and sequence trades for each floor trader and broker. Commission Regulation 1.35(g) requires an exchange to obtain the actual one-minute time of execution on each side of a trade or, if an exchange identifies and records the time, to obtain a single actual time. To comply with the one-minute timing requirement, COMEX requires floor members to record manually on a trading card the minute of execution for each side of a trade.

¹⁰ These floor order ticket reviews include three quarterly reviews opened prior to the target period and five bimonthly floor order ticket reviews that were closed during the target period. The Division found that 918 floor order tickets were examined as part of the three quarterly reviews and that 1,232 floor order tickets were examined during the five bimonthly reviews. Although the Exchange's procedures stipulate that a minimum of 30 floor order tickets will be selected for review, during the target period, the actual number of tickets examined as part of the completed

bimonthly reviews ranged from 63 to 537. The 30 ticket minimum is in place to accommodate the smaller, less active broker groups.

- 11 The Division examined order tickets associated with an order ticket review completed after the target period because the Exchange returns order tickets to clearing firms once an order ticket review is completed. Because the January 1998 floor order ticket review was completed outside the target period, the statistical results are not included in the Division's total count of floor order tickets examined by the Exchange during the target period.
- 12 As noted above, PCMs are responsible for maintaining members' original trading cards.
- 13 The Broker vs. PCR Report evaluates trade times by comparing the times recorded by brokers and traders on their trading cards to the time recorded in the Exchange's price change register ("PCR"). COMEX deems a trade execution time to be accurate when it is within one minute on either side of the minute that a corresponding price was reported in the PCR. Based on this comparison for all trades executed during the preceding month, the Broker vs. PCR Report generates a monthly accuracy percentage for every COMEX broker and trader.
- 14 The Broker vs. Broker Report compares floor members' reported execution times for several randomly selected days each month to the times reported by floor members for the opposite side of the trade to identify instances where the buy and sell times do not match.
- 15 The Broker On-Time Trade Summary Report identifies members who fail to input trade data through the Exchange's On-Line Trade Entry System within 30 minutes following the 30-minute trading bracket during which the trade occurred.
- 16 Re-reviews of members are conducted within six months of the initial audit trail review when the member was found deficient. Members who are re-reviewed are tested for compliance with all audit trail requirements, not only the rules that the member initially failed.
- 17 The Exchange explained to the Division that it does not review the complete group selected for an audit trail review for collection timeliness because the review is extremely time consuming and labor intensive. Although Exchange procedures call for the Compliance Department to examine a minimum of five members per month for collection timeliness, in practice, the Compliance Department examines more. For the 13 audit trail reviews closed during the target period, the number of members reviewed for collection timeliness ranged from four members to 11, with an average of seven members reviewed each month. In addition, as discussed below, all trading cards examined during the course of a trade practice investigation are checked for collection timeliness. See note 19.
- 18 The Division stated in the 1993 Review that COMEX could enhance the usefulness of its monthly audit trail reviews by increasing the number of trading cards and members examined. The Division had found that, for the target period then under review, the Exchange had completed 14 audit trail reviews for which it reviewed a total of 2,742 trading cards, an average of 196 cards per month, and that the number of members selected for each review ranged from eight to 22. Thus, the Exchange's new audit trail review procedures have increased by more than five times the number of trading cards examined and have significantly increased the number of members examined.
- 19 Trading cards reviewed in conjunction with a trade practice investigation are subject to the same standards of review that exist for audit trail reviews and are also tested for collection timeliness.
- 20 As explained in Section V.D.1. below, the Division examined all of the trade practice investigations closed by the Exchange during the target period.

- 21 The Compliance Department concluded in Investigation No. 06-973-050697 that two members engaged in five instances of noncompetitive prearranged trading from May through September 1997. Subsequent to the close of the target period, one member was ordered to pay an \$11,000 fine and the other member was ordered to pay a \$15,000 fine.
- 22 This also was a problem identified by the Division in the 1993 Review. Toward that end, the Division recommended that the Exchange improve member compliance with the requirement that a new trading card be used at the beginning of each designated 30-minute trading interval. The Division notes that the problem identified during the present review is largely attributable to two members out of the group of 20 members whose trading cards were examined. In addition, the illegibility of a large number of trade times for one of these members had a substantial impact on the overall trading card recordkeeping score of the entire group.
- 23 Since members are required to use a new trading card at the beginning of each 30-minute bracket, all trades recorded on a single trading card should be executed during the same hour.
- 24 As explained below, during the target period, the Exchange began an initiative to hire more experienced trade practice surveillance staff. Therefore, the Division's evaluation of COMEX's staffing went beyond the target period and is intended to present a clear picture of the Exchange's trade practice surveillance staff as of May 1999. A listing of trade practice surveillance personnel and an organizational chart can be found in Appendix 1.
- 25 See May 4, 1999 letter from David Schneiderman, Director, Trade Practice Surveillance, to Rachel Bardansky, Special Counsel, Division of Trading and Markets, included in Appendix 2.
- 26 CTI is a numerical code used to identify the source of trades as follows: CTI 1 designates a trade by a member for his or her personal account or an account for which he or she has discretion; CTI 2 is a trade for his or her clearing member's house account; CTI 3 is a trade for another member present on the floor or an account controlled by such other member; and CTI 4 is a trade for any other type of customer.
- 27 Samples of TSER review logs are included in Appendix 3.
- 28 The Broker Unmatched Trade Report shows all unmatched trades broken down by member for a specific date. The Correction Audit Trail Report displays intra-day changes made to the details of a trade and is sorted by transaction identification number. The Trade Audits Department, which is not part of the Exchange's Compliance Department, assists members with trade corrections.
- 29 Samples of the Compliance Department's floor observation schedules and memoranda with instructions to staff are included in Appendix 4.
- 30 Samples of Weekly Floor Observation sheets are included in Appendix 5.
- 31 Samples of the COMEX Division Open Case List are included in Appendix 6. Commission Regulation 8.06 requires that an investigation generally be completed within four months, except when significant reason exists to extend it beyond that time frame. Significant reasons may include the complexity of the matter, as well as the number of documents required to be analyzed in order to properly determine if a rule violation occurred.
- 32 The Division referral involved possible trading ahead by 19 Exchange members. The Exchange subdivided the referral into 19 separate investigations. After reviewing the involved members' trading records, Compliance Department staff determined that there was not a reasonable basis to believe that Exchange rules were violated, except in one instance. However, warning letters were

issued to eight members for various trading card violations discovered during the course of the investigations. The investigation regarding the instance in which the Compliance Department believed that a member may have traded ahead of his customer's order, Investigation No. 06-023-121097, was still ongoing at the end of the target period.

33 A December 9, 1997 letter from David Schneiderman, Director, Trade Practice Surveillance, to Rachel Berdansky, Special Counsel, Division of Trading and Markets, describes this policy and is included in Appendix 7.

34 Ten closeout memoranda were written between one and two months after the appropriate sign-off sheets were signed, one was written three months after a sign-off sheet was signed, one was written six months after a sign-off sheet was signed, two were written seven months after sign-off sheets were signed, one was written ten months after a sign-off sheet was signed, and one was written 15 months after a sign-off sheet was signed.

35 There were two investigations that were open prior to the target period and remained open at the close of the target period. Investigation No. 06-962-04197 was closed by the Compliance Department on January 22, 1999, and was referred to a disciplinary committee. On February 24, 1999, a complaint was issued against two members alleging various violations of Exchange rules involving prearranged and non-competitive trading. The other investigation, Investigation No. 06-932-110596, involved a member who had previously been sanctioned. Because this member had failed to pay his monetary penalty, his membership was revoked. The Compliance Department did not actively pursue the more recent investigation due to the revocation.

36 Contract Market Rule Enforcement Program Guideline No. 2, 1 Comm. Fut. Law Rep. (CCH) ¶ 6430 (May 13, 1975).

37 Section IV.B.1. above describes the Exchange's recordkeeping summary disciplinary program.

38 Disciplinary Rule 3.13 requires that the COMEX Panel be comprised of 70 percent COMEX members and 30 percent NYMEX members. The rule further requires that the nine members include at least one person who is neither an Exchange member nor employed by an Exchange member or member firm. The remaining committee members are to include floor brokers, locals, traders, and FCMs.

39 Disciplinary Rule 3.10 requires that each COMEX Hearing Panel be comprised of 70 percent COMEX members and 30 percent NYMEX members. The rule further requires that each Hearing Panel include at least one person who is neither an Exchange member nor employed by an Exchange member or member firm. The remaining Hearing Panel members are to include floor brokers, locals, traders, and FCMs.

40 Disciplinary Rule 8.16.

41 Disciplinary Rule 3.03 defines disqualifying disciplinary offenses generally to include any violation of the Act or Commission regulation, and any violation of a self-regulatory organization's rules, except those rules related to: (1) decorum or attire; (2) financial requirements; or (3) reporting or recordkeeping, provided that the violation(s) did not result in fines aggregating \$5,000 or more within a single calendar year.

42 Disciplinary Rule 8.03. Any settlement agreement approved by or entered into with the BCC is subject to Board approval.

⁴³ Disciplinary Rule 8.02(C).

⁴⁴ Disciplinary Rule 8.02(D).

⁴⁵ The BCC also will direct the Compliance Department to notify the subject of its findings. Disciplinary Rule 8.02(E).

⁴⁶ Disciplinary Rule 8.03(B) and (D).

⁴⁷ Disciplinary Rule 8.04(C) defines "respondent" as a member, member firm, or employee of any of the foregoing against which a complaint has been filed.

⁴⁸ Under Disciplinary Rule 8.05, the respondent may file a written answer to the complaint and request a hearing within ten business days of service of the complaint. Disciplinary Rule 8.04(D) provides that the respondent's failure to request a hearing within the provided time frame will generally operate as a waiver of a right to a hearing.

⁴⁹ Disciplinary Rule 8.08.

⁵⁰ Disciplinary Rules 8.11(D) and (E).

⁵¹ Disciplinary Rules 8.11(A), (B), and (K).

⁵² Disciplinary Rules 8.12(A) and 8.13.

⁵³ Disciplinary Rules 8.16, 8.17, 8.18, 8.19, and 8.20 include a complete description of the Exchange's appeals process.

⁵⁴ The Disciplinary Register is a list of all disciplinary actions taken by the Exchange and includes for each action, among other things, the name of the respondent, the investigation number and assigned disciplinary case number, the date the investigation resulting in disciplinary action was initiated, the date an action was presented to the BCC, the date any complaint was served or settlement reached, the date any hearing was held, rule violations charged, and sanctions imposed.

⁵⁵ Subsequent to the target period, additional penalties were imposed in two disciplinary actions that were pending during the target period. These penalties included a \$15,000 fine, a two-week suspension, and a cease and desist order for noncompetitive trading. None of the members involved in either action had a previous disciplinary history.

⁵⁶ The Hearing Panel's decision for Disciplinary Case No. 01-782-94, discussed in more detail below, was issued prior to the target period.

⁵⁷ On July 23, 1998, the NFA issued a notice of intent to revoke the member's registration based on the Exchange's disciplinary action. Three other members also were involved in the original matter. However, these three members executed settlement agreements with the Exchange prior to the target period and were sanctioned as follows: one member was fined \$15,000 and was suspended for one-week; one member was fined \$50,000, of which \$25,000 was suspended with the proviso that any subsequent similar rule violations would result automatically in the imposition of the suspended portion of the fine, and the member was suspended for four weeks (a recent Commission action statutorily disqualified this member); and one member was fined \$2,000.

⁵⁸ Disciplinary Case No. 97-03.

⁵⁹ The Division recommended in the 1993 Review that the Exchange consider members' past disciplinary history when imposing penalties.

⁶⁰ Disciplinary Case No. 97-04.

⁶¹ A notice of charges is the equivalent of the Exchange's complaint and states the conduct in which the member is alleged to have engaged, the rule violation alleged, the predetermined penalty, and the member's rights with respect to a hearing. Commission Regulation 8.11.

⁶² See note 57 for a description of the terms of the settlements.

⁶³ Disciplinary Rule 8.11(B).

Updated February 1, 2001

Return to: [Previous Page](#)

Morningstar.com's Interactive Classroom

Course 102

The Stock Exchanges

Introduction

When a company decides to issue stock to raise capital, one of the most important things it has to decide is where that stock will be traded. Most stocks are traded on exchanges, which are places where buyers and sellers get together and decide on a price. Some exchanges are physical locations, where buyers and sellers make their transactions on a trading floor; others are virtual locations, consisting of a network of computers. Each of the exchanges is different, and all have evolved over the years.

The New York Stock Exchange

The oldest and most prestigious exchange in the United States (or indeed in the world) is the New York Stock Exchange (NYSE, also known as the "Big Board"), at Broad and Wall Streets near the southern tip of Manhattan. The NYSE traces its beginnings to 1792, when 24 brokers, under a buttonwood tree on Wall Street, signed an agreement to trade securities on a commission basis. One of the first two stocks listed on the NYSE was the Bank of New York BK, which is still traded there. In 1817 the Exchange wrote its first constitution, and in 1903 it moved into its present home at 18 Broad Street.

Trading on the New York Stock Exchange is done on a large trading floor. Orders to buy and sell specific stocks come into brokerage firms that are members of the Exchange, and these firms transmit the orders to floor brokers. A floor broker goes to a designated place on the floor where a specific stock trades (known as a trading post) and executes the order with another broker who specializes in trading that stock. Prices are determined through supply and demand. Once the deal is made, the price and amount are transmitted back to the brokerage firm, which then notifies the person who placed the order.

In order to be listed on the New York Stock Exchange, a company has to meet a rigorous set of standards. Among those standards, its stock has to be worth at least \$60 million and the company has to have had at least \$2 million in earnings for each of the past two years. There are also cash flow requirements and standards involving minimum number of shareholders and shareholder rights. Companies that cannot meet all the standards can be admitted on a case-by-case basis, but they generally have to be substantially bigger and more

established companies to do so.

Even with all this, a company still has to get the stamp of approval of the Exchange, which wants to ensure that the companies it lists are stable. Once it gets approval, the company is assigned a ticker symbol of one to three letters, which is used as its unique identifier in making trades.

Nasdaq

Until recently, all of the biggest public companies in the United States were listed on the NYSE, and only second-tier companies traded elsewhere. Now, however, many of the largest companies in the U.S. trade on Nasdaq (National Association of Securities Dealers Automated Quotation system), an entirely computer-based system, which has become a serious rival to the New York Stock Exchange.

Nasdaq developed out of a network of brokers linked by telephone, which was formalized and linked by computer in 1971. Trading of Nasdaq stocks is done through brokerage firms, much as in the NYSE, but there is no trading floor. Instead, orders are sent out over a distributed network of thousands of computers, where "market makers" give the prices at which they are willing to buy and sell any specific stock. Once a price is agreed upon, the order is completed electronically. The number of shares traded on Nasdaq is now routinely higher than the number traded on the NYSE, which makes sense because Nasdaq has more stocks listed.

There are actually two levels of Nasdaq. The more prestigious of these is the Nasdaq National Market, with around 4,000 stocks. In order to be listed here, companies have to meet listing requirements that are similar to those for the NYSE; in fact, more than a quarter of the Nasdaq National Market stocks would qualify for listing on the NYSE but choose to trade on Nasdaq instead. These stocks include such big technology names as Microsoft MSFT, Intel INTC, and Cisco CSCO.

In addition, there's the Nasdaq SmallCap Market, containing about a third as many stocks as the National Market. As the name implies, this market is for stocks of companies that aren't big enough to meet the listing requirements of the major Nasdaq market, but that still want the prestige and liquidity of trading on a regulated market.

The American Stock Exchange

The third-biggest national stock exchange is the American Stock Exchange, or Amex. Until the 1950s, it was known as the "Curb Exchange," because it originated with brokers meeting on the curb outside the New York Stock Exchange to trade stocks that didn't

qualify for the Big Board. Those days are long gone, as Amex now has a trading floor located just up the street from the NYSE, and trading at the two places is done in much the same way. In 1998, the National Association of Securities Dealers, the parent of Nasdaq, bought Amex and combined the two markets into the Nasdaq-Amex Market Group.

The role of Amex has changed over the years. It used to be a major alternative to the NYSE for large U.S. stocks, but Nasdaq now fills that role, and the stocks currently trading on Amex are virtually all small- and mid-cap in size. Most of the trading on Amex these days is in options and other derivatives, whose value depends on the price of some security or index of securities. Since derivatives have become very popular, they have helped Amex to continue thriving.

Regional Exchanges

In addition to the national stock exchanges, there are four regional exchanges: The Boston Stock Exchange, the Chicago Stock Exchange, the Pacific Exchange (in San Francisco and Los Angeles), and the Philadelphia Stock Exchange. There's also the Cincinnati Stock Exchange, which, despite its name, is a purely electronic market (like Nasdaq) with its headquarters in Chicago.

These regional exchanges started as places for trading the stocks of local companies, which didn't want to, or couldn't afford to, be listed on a national exchange. Some such stocks still trade on these exchanges, but the majority of the activity is now in nationally listed stocks, which also trade on one of the major national markets. The Chicago, Pacific, and Philadelphia Stock Exchanges have also followed Amex in becoming major centers for the trading of options and derivatives.

Over-the-Counter (OTC) Stocks

Thousands of stocks not listed on the NYSE, Nasdaq, or Amex are traded on the over-the-counter (OTC) market. This term used to include Nasdaq stocks, since they are not traded on an exchange with a physical trading floor, but now it's used almost exclusively for small or marginal companies that don't meet the listing requirements of any of the regulated markets, including Nasdaq. These stocks are sometimes called "pink sheet" stocks, a term left over from the days when lists of over-the-counter stocks were printed on pink paper.

Since they are so small and often financially questionable, OTC stocks tend to be risky and to trade infrequently. However, the very fact that they are so thinly traded means that the chance of finding a bargain price is greater than in stocks traded on an organized market; thus some people like to buy OTC stocks in the hopes of

making quick gains. This is made easier by the fact that the share prices of most OTC stocks are low, often under \$1.00, but it's made harder by the fact that information on these stocks is hard to come by and often unreliable. Trading in OTC stocks is a lot like gambling, and it is not something we recommend for beginners.

Quiz 102

There is only one correct answer to each question.

- 1 Which of the following is a major difference between the New York Stock Exchange (NYSE) and Nasdaq?
 - a. Stocks of all the largest companies are traded on the NYSE.
 - b. The NYSE, unlike Nasdaq, has a physical trading floor.
 - c. Only stocks which don't qualify for listing on the NYSE trade on Nasdaq.
- 2 Which of the following is not a requirement for a company to be listed on the New York Stock Exchange?
 - a. Its stock has to be worth at least \$60 million.
 - b. It has to have had at least \$2 million in profits the previous two years.
 - c. It has to have been in existence for at least five years.
- 3 Currently, the American Stock Exchange (Amex) is:
 - a. The major alternative to the New York Stock Exchange for large-cap stocks.
 - b. A major center for trading options and other derivatives.
 - c. A completely computer-based exchange with no trading floor.
- 4 Which of the following is not a characteristic of OTC stocks?
 - a. They are traded on their own separate trading floor.
 - b. They tend to be smaller companies that can't meet the listing requirements of the major exchanges.
 - c. Information about them is hard to find and unreliable.
- 5 Trading at the New York Stock Exchange is completed:
 - a. On a trading floor with prices dictated by supply and demand.
 - b. Entirely over a network of computers scattered across the country.
 - c. By secret ballot.

To take the quiz and win credits toward Morningstar Rewards go to [the quiz page](#).

© Copyright 2002 Morningstar, Inc. All rights reserved.

Return to: [Previous Page](#)